AR86

2006 Annual Report

Transforming Energy into Action

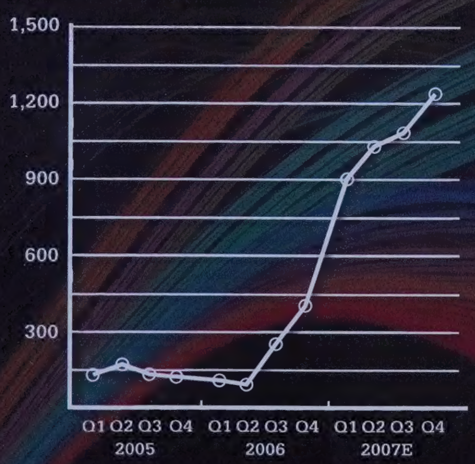
Action Energy Inc.

Profile: Action Energy Inc. is a Calgary, Alberta-based emerging exploration and production company that commenced trading on the TSX Venture exchange (symbol: AEC.V) in November 2006. The Company has assembled a portfolio of oil and natural gas properties providing a balanced growth profile. Action intends to create shareholder value through the successful exploitation of repeatable, low-risk development opportunities, high-impact full-cycle exploration, and complementary strategic acquisitions, while maintaining a strong balance sheet.

Action exited 2006 with production of 840 boe per day and sharply higher monthly cash flow, providing a solid foundation for further growth in 2007.

Annual General Meeting: The Annual General Meeting will be held at 3:00 p.m. (Mountain Daylight Time) Tuesday, July 31, 2007 in the Viking Room at the Calgary Petroleum Club, 319 Fifth Avenue S.W., Calgary, Alberta, Canada. Shareholders are encouraged to attend. Those unable to attend should complete and return the form of proxy.

Quarterly Production (boe/d)



Contents:

Our value is derived from:

- Low-risk oil and natural gas drilling opportunities at Lloydminster, Alberta and Shackleton, Saskatchewan, with more than 500 high-working-interest development opportunities.
- High-impact light crude oil and liquid-rich gas exploration prospects through strategic, low-entry-cost farm-ins in the Peace River Arch and Sylvan Lake areas.
- Energy, work ethic, commitment and accountability demonstrated by our employees.

Strategies and Achievements

248,296
net acres*

Strategy
Identify and assemble large land positions with potential for multi-year activities ranging from low-risk exploitation to high-impact exploration. Focus on farm-ins and acquisitions amid current high land prices.

Rationale
Land is the foundation for long-term growth. Focusing on joint ventures accelerates the exploration cycle time and reduces land acquisition costs.

2006 Execution
Action assembled large land positions at Shackleton, Lloydminster and the Peace River Arch at below industry-average land costs. Action substantially reduced initial development risk by drilling multiple appraisal wells to ensure production and cash flow from future development drilling.

2007 Target
Drill commitment exploration wells to earn large farm-in positions. Seek additional farm-ins. Participate in Crown land sales if prices ease as expected.

*At year-end 2006.

80%
average working interest

Strategy
Attain and maintain high average working interest and operatorship of nearly all assets and drilling projects.

Rationale
Controls capital allocation and the focus and pace of exploration activities. Maximizes impact of successful exploration/development/optimization. Facilitates customized drilling and production designs, optimization of production and control of operating costs.

2006 Execution
Lloydminster project at 100 percent working interest. Shackleton play at 63.5 percent average working interest. Three new farm-ins providing working interest of up to 100 percent (subject to gross overriding royalty). Action operates 90 percent of production and 90 percent of planned 2007 drilling.

2007 Target
Increase operatorship, maintain high working interests in development projects, and maintain meaningful working interest in high-risk projects by promoting industry partners.

100 low-risk horizontal infill locations

Strategy
Drill low-risk, repeatable exploitation opportunities to generate steady production and cash flow growth.

Rationale
Cash flow funds ongoing growth program, including higher-impact exploration. Lloydminster assets provided perfect opportunity to execute this model.

2006 Execution
Moved quickly to begin exploiting 100 percent working interest Lloydminster assets. Planned first phase, 16-well horizontal infill program and evaluated natural gas potential.

2007 Target
Drilled first 16 horizontal wells in Q1. Tie-ins will increase production substantially. Exploration of Sparky oil potential and uphole natural gas. Up to 100 further low-risk horizontal oil wells to be planned.

$33 million acquisition

Strategy
Buy-and-build approach to complement existing operating areas.

Rationale
Shorten exploration cycle time, add production and exploration/ development/exploitation prospects, hold down operating and overhead costs.

2006 Execution
November 2006 share-for-share acquisition of High Plains added 11 properties, approximately 150,000 net acres of land and low-risk growth opportunities.

2007 Target
Continue to evaluate underperforming companies for potential corporate acquisitions.

Letter to Shareholders

We are pleased to report on Action Energy's beginnings as a public company and to welcome our new shareholders. Action achieved strong growth over the course of 2006 in all areas of its operations. Our land base grew from 100,000 net acres at the start of 2006 to 250,000 net acres at year-end, with Action incurring land acquisition costs significantly below prevailing market prices.

We achieved an approximately eight-fold increase in production from 100 boe/d at the start of the year to 840 boe/d at year-end. We participated in two prolific Leduc light oil discoveries at Sylvan Lake, adding a number of development opportunities for 2007.

On the financial side, we strengthened our balance sheet by raising $35 million of equity in February 2006, providing us with strong financial positioning amid a softer public capital market. In November we completed a share-for-share strategic corporate acquisition of High Plains Energy Inc., becoming a TSX Venture-listed company with a market capitalization exceeding $80 million. And, despite an overheated labour market, which made recruitment and retention of high-quality staff a challenge, we doubled our technical and supporting staff to 11 full-time employees.

Left to right:
Adeline Roth,
VP Finance and Controller;
R.D. (Bob) Bowman,
President and Chief Operating Officer;
Roger C.W. Tang,
Chairman and Chief Executive Officer.

Having a combination of oil and natural gas properties that exhibit a range of risk versus potential reward is at the core of Action's growth strategy. For Action, 2006 was a building year. We invested our resources assembling a balanced mix of low-risk, predictable exploitation properties and higher-risk, higher-potential-reward exploration prospects, along with the right technical personnel. The execution of our strategy enabled us to accumulate a large number of drilling locations – sufficient for many years worth of vigorous field activity.

Building a base of low-risk production and cash flow

As part of the High Plains acquisition Action obtained 100 percent working interest in 3.0 net sections at Lloydminster, Alberta. The Company was attracted to these properties by their potential for low-risk production additions that can furnish steady cash flow at attractive recycle ratios and netbacks. Action has the required skill set to combine 3-D technology and short-leg horizontal pad drilling to maximize drilling success, plus the operational know-how to reduce operating costs in what is normally thought of as a lower-netback heavy oil play. In Q1 2007 we drilled our first batch of 16 horizontal wells and we have achieved a substantial production increase from our 2006 year-end rate of approximately 100 boe/d in this area. If this first phase is as successful as hoped, we have more than 100 follow-up horizontal locations available.

For Action, 2006 was a building year. We invested our resources assembling a balanced mix of low-risk, predictable exploitation properties and higher-risk, higher-potential-reward exploration prospects, along with the right technical personnel.

The November 2006 acquisition of High Plains, a seemingly undervalued junior exploration and production company, added a core area in Lloydminster and approximately 400 net boe/d of production. We see this property as offering potential to substantially increase our reserves through additional exploitation drilling.

Successful exploration program

Action's exploration program is off to a great start. In February 2006, Action participated in the drilling of two exploration wells at Sylvan Lake, Alberta and made two significant pool discoveries, each with an estimated gross 0.5-1.0 mmboe of original-oil-in-place. The first well tested at 1,750 boe/d and came on-production at 550 boe/d before special Maximum Rate Limitation (MRL) approval. The second well tested at 1,711 boe/d and came on-production at 340 boe/d without special MRL. Our working interest in both of these prolific wells is 30 percent before payout. Action has identified four follow-up locations in the Sylvan Lake area as a result of these discoveries.

Strategic acquisitions and farm-ins

Action's balanced-risk approach is also apparent in its strategy of acquiring low-risk, repeatable exploitation properties and seeking farm-in partnerships in higher-risk, high-potential-reward exploration areas. The November 2006 acquisition of High Plains, a seemingly undervalued junior exploration and production company, added a core area in Lloydminster and approximately 400 net boe/d of production. We see this property as offering potential to substantially increase our reserves through additional exploitation drilling.

In December Action completed a major farm-in agreement in the Peace River Arch area of Alberta with a senior exploration and production company. The deal provides Action with a solid foothold in a prolific exploration area in which its technical team had considerable experience and past success. The farm-in offers an effective exploration cycle, including 100 percent working interest on 50.25 sections of land and a substantial amount of pre-existing seismic and geological data.

Financial strength

Action's financial strength positions us for growth. In February 2006, Action levered its clean balance sheet and issued 21 million shares to raise $35 million in equity. A portion of the new capital was used to fund Action's acquisition and exploration activities. This financing was integral to Action's success in acquiring High Plains, funding successful exploration drilling and securing the Peace River Arch farm-in.

At the beginning of 2006, Action had a $1.5 million line of credit with a national chartered bank. Our access to debt capital was extended to $19 million at 2006 year-end as a result of the value we had created throughout the year. As of January 1, 2007, Action had positive cash flow from its existing production base and $13 million in undrawn bank lines. We are in great shape to carry out our planned 2007 capital program.

Experienced management and technical teams

Action's senior management and technical teams are among the Company's greatest assets. Many of us have achieved successes in the Western Canada Sedimentary Basin (WCSB) together at other companies in the past. Our senior management team has decades of collective experience developing and executing strategies to grow emerging to junior exploration and production companies into successful intermediates.

To execute our vision, we hired whole technical teams with strong track records – as opposed to individuals – to run our operations and drive the Company's growth. Upon completion of the High Plains acquisition and

the Peace River Arch farm-in, we brought in specialized development/exploitation and exploration technical teams with local area knowledge to operate and develop these assets. Action's strategy of matching its technical teams' experience to the particular asset helped to achieve our 92 percent drilling success rate in 2006.

Outlook and Guidance

Action plans to expand its eight core properties in 2007. We predict a softer market overall, driven by moderate natural gas prices averaging approximately $7 per mcf and relatively strong oil prices of approximately US$50-$60 per barrel. Action will continue to use a balanced combination of exploration and exploitation drilling, targeting mainly oil due to current expectations of a higher rate of return. If commodity prices were to shift in favour of natural gas, Action has the flexibility needed to adjust its operations strategy accordingly, and would do so.

We expect land prices will come off their recent record highs but remain elevated in 2007, making additional farm-ins attractive. Despite the high prices, Action may acquire more exploration properties if it identifies a suitable opportunity and additional financing is available.

As of Q1 2007, Action had a drilling inventory of approximately 500 locations. This clearly outweighs our current capital resources. Action plans to use its projected $21 million 2007 capital budget – which is up significantly from 2006 – to fund 37 gross (30 net) wells, including six exploration and development and 24 exploitation wells. Additional exploration and exploitation wells may be considered in the third or fourth quarters. Action has secured well completions services and all drilling rigs to carry out its 2007 drilling program.

Year-end production in 2007 is projected to be 1,400 boe/d, weighted 75 percent to oil. We believe we can achieve this production target through successful exploitation of existing low-risk assets that we developed in 2006. With any success in the six high-impact exploration targets we have planned for 2007, our production would likely exceed our guidance – potentially by a large margin. Action projects $9.8 million ($0.31 per share) of cash flow from operations and EBITDA of $6.9 million ($0.22 per share).

In closing, we would like to thank past and present board members and financial advisors for their support and guidance. Our employees also deserve a special thank-you for all of their hard work and success in executing the Action vision for growth.

Sincerely,

(Signed) "Roger C.W. Tang"

Roger C.W. Tang
Chairman and Chief Executive Officer

(Signed) "R.D. (Bob) Bowman"

R.D. (Bob) Bowman,
President and Chief Operating Officer
May 12, 2007

Action will continue to use a balanced combination of exploration and exploitation drilling, targeting mainly oil due to current expectations of a higher rate of return. If commodity prices were to shift in favour of natural gas, Action has the flexibility needed to adjust its operations strategy accordingly, and would do so.

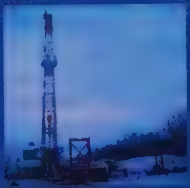
Exploitation and Exploration Review

Lloydminster Business Unit

Action's Lloydminster assets have the potential to generate significant volumes of long-life, attractive-netback heavy oil production under an innovative low-cost structure. The Company's technical teams have considerable experience and success in a number of plays in the region.

Southern Alberta, Southwest Saskatchewan Business Unit

Action has been active in this region since 2001, targeting Cretaceous plays (Mannville Group channels and Milk River marine sands) with the potential for oil and natural gas pools at low-medium risk and low-medium drilling cost.



Exploration Business Unit

Action's exploration program represents the high-potential-reward side of the Company's balanced risk profile. Action made two significant light oil discoveries in 2006, each of which tested at more than 1,500 bbls/d. Action has based its 2007 guidance entirely on its exploitation assets, without counting on further exploration success. Any significant exploration discovery in 2007 could raise production well above original guidance.

Transforming Action into Energy


Oil-focused area
ALBERTA
SASKATCHEWAN
Galahad / Red Willow
Shackleton
BRITISH
COLUMBIA

Lloydminster Business Unit

Lloydminster Business Unit

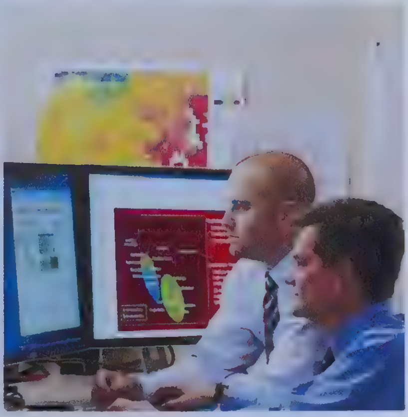
The Lloydminster heavy-oil properties represented the greatest production and reserves upside of the assets acquired with the High Plains transaction in November 2006. Action was attracted to these properties because Action believed the assets were under-explored, under-exploited and under-valued. The characteristic of long-life, low-risk, and attractive-netback oil in the region complemented Action's existing low-risk natural gas asset at Shackleton, substantially enhancing the Company's development and exploitation portfolio. Typical reserves from the Lloydminster Formation are estimated at 75,000 boe per well from conventional horizontal development.

Action holds 100 percent net working interest in three sections at Lloydminster. Each section is at a stage of maturity that will enable further activities. The Company views this land as amenable to infill drilling at up to 64 horizontal wells per section. One of the three sections, Section 29, had six existing vertical wells previously drilled to delineate the pool boundary, all of which were commercial producing wells. Production was approximately 100 boe/d in late 2006. In November and December Action planned its first batch of 16 horizontal exploitation wells to be drilled on Section 29.

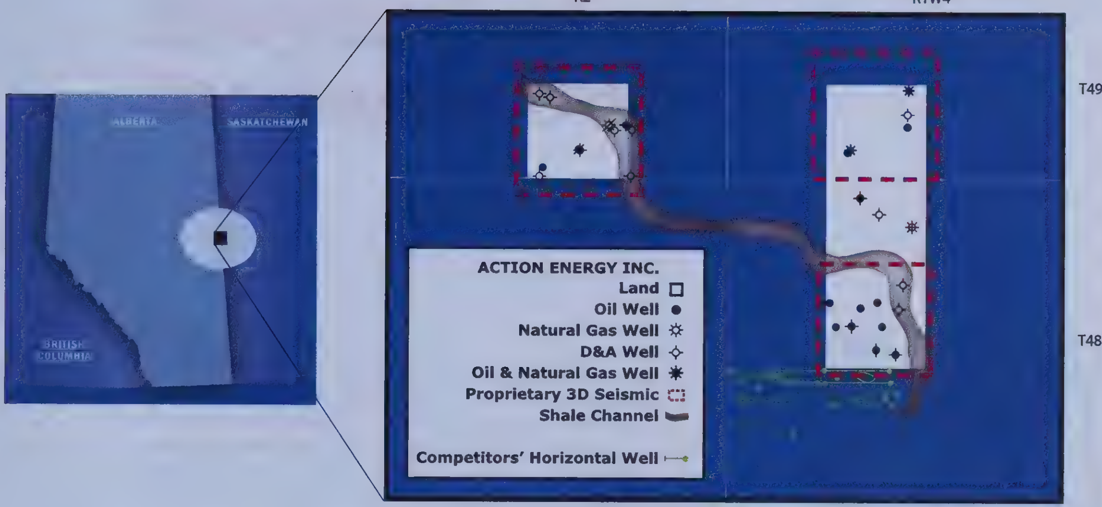
To reduce capital costs and to minimize environmental impact, Action's technical teams in the past pioneered a multi-well pad-type facility drilling and production tie-in approach. This concept reduces the surface disturbance and achieves high capital efficiency. Action will apply this model at Lloydminster. By late Q1 2007, the Company had completed the first 16-horizontal-well drilling phase, achieving 100 percent drilling success within budget.

Reserves of a typical horizontal well from the Lloydminster Formation range from 70,000 boe to 90,000 boe, providing higher production and lower finding and development costs per boe than vertical development. Action believes it can dramatically increase production at Lloydminster by tying in the 16 new horizontal wells and through future infill drilling. In 2007 and over the medium term, Lloydminster is anticipated to provide significant organic growth.

Kelly Knibbs, Production Superintendent.



Left to right:
Jeff Rideout, Land Manager;
James Schneider, Operations Manager;
Not pictured: Josh Caswell, Senior Geologist.



Upside

Action booked limited initial reserves when it acquired the Lloydminster properties as part of the High Plains transaction in November 2006. The Company saw an opportunity to increase reserves by horizontal development drilling in the Lloydminster Formation. Through integrated 3D interpretation and detailed geological mapping, the Company also identified up-hole exploration targets and bypassed oil pay in the Sparky Formation. In Q1 2007, Action drilled a vertical exploration well targeting the Sparky Formation in Section 29. It was completed as a discovery oil well. The new pool is estimated to cover 0.5 sections (320 net acres) and has the potential to add to Action's inventory of horizontal development wells and to contribute to future reserve additions from existing infrastructure.

The Lloydminster properties also offer financial upside through low-cost production that supports favourable heavy oil netbacks. Action has the knowledge to reduce its operating costs per unit of production significantly through the multi-well pad approach, which avoids costly single-well batteries and production trucking, and by using up-hole natural gas as a fuel to generate on-site power. Going by previous experience, this approach can reduce operating costs by $3.00-$4.00 per boe, thereby allowing Action to achieve a heavy oil netback in the range of $22.00-$24.00 per boe (at the current WTI price and heavy-light differential).

Quick Facts: Lloydminster Business Unit

Land: 1,920 net acres

Year-end 2006 production: 100 boe/d

Targets:
Long-life, low-risk, attractive-netback conventional heavy crude oil in the Lloydminster and Sparky formations

2006 wells drilled:
Sixth of six vertical wells drilled by previous owner to delineate pool

2007 locations:
Sparky oil discovery drilled in Q1; 16 Lloydminster horizontal exploitation wells drilled in Q1, achieving 100 percent success; three additional wells being considered

Inventory:
Action's horizontal drilling inventory in the area is approximately 100 wells

Lloydminster Business Unit

Development Approach

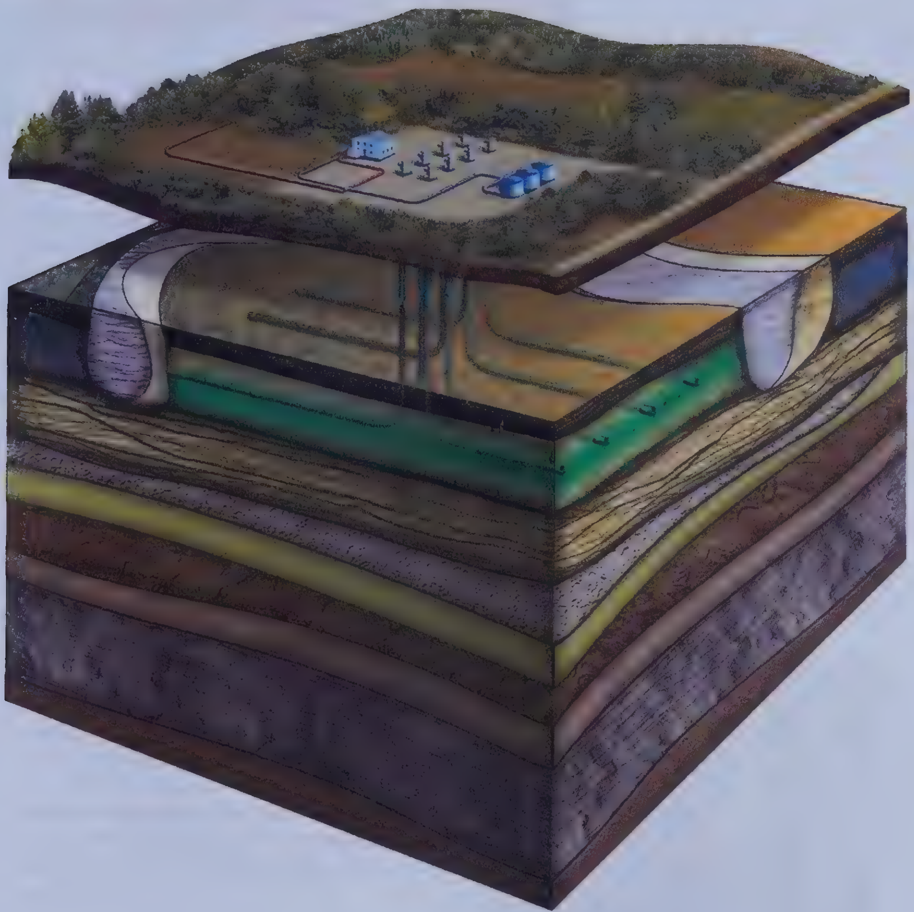
Action intends to use a similar development approach for all of its Lloydminster-area properties. Based on geological analysis and 2D seismic, Action begins by using a number of vertical wells to delineate a known pool's boundaries. The Company then shoots 3-D seismic to identify additional targets and to guide the placement and direction of horizontal wells. Finally, Action drills horizontal development and exploitation wells at high density to sweep the entire pool and maximize recovery of the hydrocarbons.

Lindbergh and other minor properties

Lindbergh, Alberta is a geological "carbon copy" of Action's Lloydminster property that requires vertical wells to delineate the pool boundary. Action holds 100 percent working interest in two sections of land in the area. The primary target in the Lindbergh area is the General Petroleum (GP) Formation, which produces conventional heavy crude oil of 13° API within the same low-risk, repeatable play concept as the other Lloydminster properties. In 2006, Action drilled one vertical well to begin evaluating geological reservoir parameters for potential in-fill development using horizontal wells. Based on 3-D seismic, Action is considering a combination of vertical wells and pilot horizontal wells in 2007 to further delineate the pool.

In 2006, Action also participated at 50 percent working interest in a non-operated exploration well in a minor property at Martin Hills, Alberta. The successful exploration well targeted multiple Cretaceous gas reservoirs and in December 2006 was brought on-production at 1.5 mmcf/d (0.75 mmcf/d net) from a commingled, triple-zone reservoir. Action is considering additional drilling opportunities at Martin Hills in 2007.

Lloydminster Geology



Action's play type in the Lloydminster area is Cretaceous-aged shallow marine sandstone trapped by an up-dip shale-filled channel. The deepest producible target is at approximately 600 metres. Strong oil prices with attractive differentials, relatively low drilling costs, lower operating costs and the multiple pay zones in the Lloydminster area make this an attractive play for additional development and exploitation drilling in 2007.

Southern Alberta, Southwest Saskatchewan Business Unit

Shackleton, Saskatchewan

Action since 2001 has assembled a large land position in southwest Saskatchewan's Shackleton area, targeting shallow natural gas in the Milk River Formation. The development approach for the Milk River Formation is similar to typical resource-type plays, requiring substantial landholdings and large initial capital investment to support subsequent drilling of numerous repeatable wells.

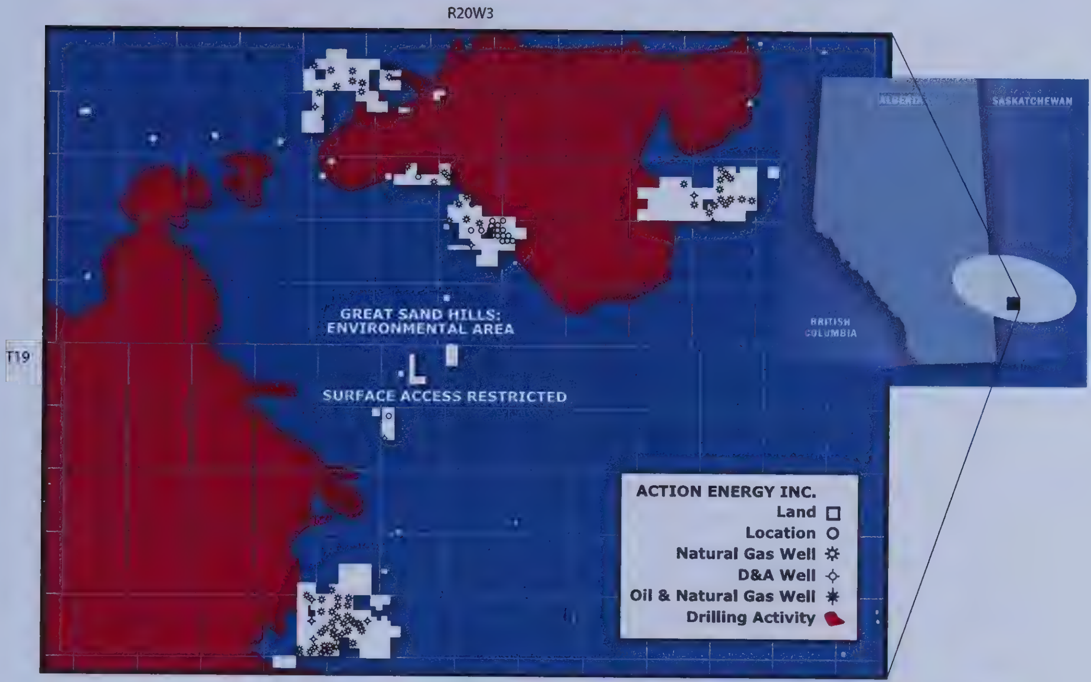
Action is the third-largest landowner in the Shackleton area, with an average 63.5 percent working interest in 190 gross (121 net) sections of land, most of which have expiry dates in 2009 and 2010. Action also owns gas processing facilities at Russelton and Crane Lake as well as gas gathering systems in the area. All of Action's interests in the Shackleton area are Company-operated.

Production in the Shackleton area was 100 boe/d at year-end 2006. In 2007, Action plans to drill 12 exploitation wells out of its Shackleton-area drilling inventory of approximately 400 targets. The Company was planning to drill the first six of these wells by the end of Q3.

Galahad/Red Willow, Alberta

Action's Galahad/Red Willow properties produce medium-gravity (25° API) crude oil from the Leduc and Camrose formations and natural gas from multiple zones within the Mannville Group. The property was producing 240 boe/d net at year-end 2006, weighted 50-50 natural gas and oil. In Q1 2007, Action commenced a multiple-well workover campaign and re-interpretation of existing 3D seismic data. Initial results were encouraging and additional well-by-well reviews are underway. In 2007, Action plans to drill three step-out wells in this area. All infrastructure in the Galahad/Red Willow area is Company-owned and -operated, with an average working interest of 97 percent.

Left to right:
Jeff Rideout, Land Manager;
James Schneider, Operations Manager;
Warren Doenz, VP Exploitation.



Minor Assets

Action holds 10 sections of land at 100 percent working interest in the Eagle Butte area of southeastern Alberta. In Q4 2006, Action drilled an exploration well in the area, which was dry. Reworking of 2D seismic is underway to define additional locations in 2007.

Non-Canadian Assets

Action holds 90,000 net acres of exploration lands in northern Montana that were acquired as part of the High Plains transaction. This non-core asset was producing 90 boe/d net, weighted 89 percent to natural gas, at year-end 2006. No immediate wells are currently planned on this asset, but Action is evaluating strategic alternatives including new drilling, farm-out or divestment opportunities in 2007.

Quick Facts: Southern Alberta, Southwest Saskatchewan Business Unit

Land: 199,515 net acres

Year-end 2006 production: 430 boe/d

Targets:
Camrose Formation medium crude oil and Milk River Formation shallow gas

2006 wells drilled:
15 wells drilled in Shackleton

2007 locations:
Reworking existing area assets and three new oil/gas wells at Red Willow and 12 new shallow gas wells at Shackleton are currently underway or planned

Inventory:
Action's drilling inventory contains approximately 400 shallow gas targets at Shackleton and up to eight workover candidates at Red Willow

Exploration Business Unit

Sylvan Lake, Alberta

Action's Sylvan Lake properties are located within the pinnacle reef fairways along the west side of the Rimbey-Meadowbrook Leduc Barrier Reef Trend in west central Alberta. The Sylvan Lake assets are integral to Action's high-impact, high-potential-reward exploration program. Targets in this area hold slightly sour light crude oil (43° API) within Devonian-aged, Leduc Pinnacle Reef formations at depths of approximately 3,200 metres.

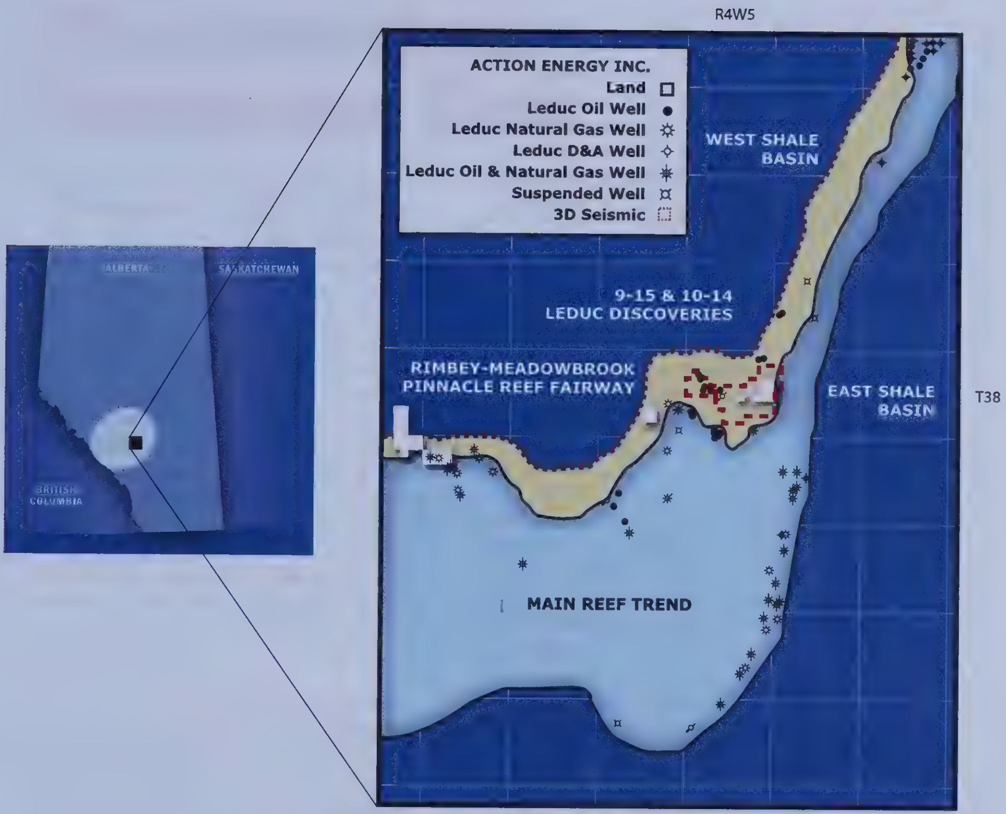
In Q1 2006, Action secured a farm-in with a junior exploration and production company, obtaining a 30 percent working interest before pay-out (15 percent after pay-out) in two quarter-sections on two sections of land in return for drilling a minimum of one commitment well per spacing unit.

In mid-2006 Action participated in the drilling of two Leduc exploration wells under this farm-in, making two new pool discoveries. Each discovery holds an estimated 0.5-1.0 mmboe of original-oil-in-place. The first well, 9-15, tested at 1,750 boe/d and came on-production at 550 boe/d before receiving special maximum rate limitation (MRL) regulatory approval. The second well, 10-14, tested at 1,711 boe/d and came on-production at 340 boe/d, also before special MRL. The production capability of the wells was further restricted by the bottleneck at the existing processing facility in the area.

By late Q4 2005, Action had identified several further high-impact Leduc Pinnacle Reef exploration prospects from extensive new 3-D seismic and geological analysis. Action approached Crown land mineral-rights holders and subsequently completed a second farm-in in December 2006. This deal, on Section 24-38-4W5, provides Action with 100 percent of any commercial production prior to payout of Action's drilling and completion expenses. Following payout Action retains a 65 percent working interest in the remaining reserves.

Production in the Sylvan Lake area at year-end 2006 was 190 boe/d net. Although the special MRL application was approved in December 2006, the wells were only able to increase production slightly due to the processing bottleneck. Construction of a new oil battery was underway in Q1 2007 and the facility is expected to be on-stream by Q2,

Left to right:
Douglas Cole, VP Corporate Development;
Ron Honch, Geological Manager;
Jim Corner, Chief Geologist;
Jeff Rideout, Land Manager.



with an initial throughput capacity of 5,000 boe/d. Other infrastructure in the area is accessible through third parties.

In its 2007 capital budget the Company has included one 100 percent working interest Leduc Pinnacle Reef exploration well to be spudded on Section 24 (the second farm-in) by July 31, 2007. In addition, Action has identified four follow-up locations as a result of its two discoveries on the first farm-in. Two 15 percent working interest wells are planned for 2007, one each in Q3 and Q4.

Given successful infrastructure construction and tie-in activities from the planned development drilling on Section 14 and Section 15, combined net production from Sylvan Lake could reach a peak of 275 net boe per day later in 2007, without any production contributions from 2007 exploration in this area.

Quick Facts: Sylvan Lake

Land: 736 net acres

Year-end 2006 production: 190 boe/d

Targets:
Premium slightly sour light Devonian-aged Leduc crude oil

2006 wells drilled:
Two exploration wells making two new pool discoveries

2007 locations:
One exploration well to be drilled in Q1 and possibly two development wells in Q3/4 as part of 2007 capital budget

Inventory:
Action has identified four possible targets as a result of its discoveries

Exploration Business Unit

Peace River Arch Region Farm-in

Action's exploration business unit was very active in building a large land position in the Peace River Arch area in 2006. The Company was attracted to this area by the potential to discover sweet, light crude oil and high-heat and liquids-rich natural gas. In December 2006, Action secured 32,160 net acres in the Peace River Arch through a 50.25-section joint venture agreement on three main land blocks with a senior exploration and production company. Upon completing the drill-to-earn commitments at various stages, which includes five wells to be drilled before year-end 2007, Action will earn 100 percent working interest over the entire land base, subject to a non-convertible gross overriding royalty of 12.5 percent on any successful future production.

The Peace River Arch Farm-in Agreement gave Action access (subject to meeting the specified drilling commitments) to a multi-zone exploration property on three blocks offering large, light-oil and liquids-rich natural gas prospects at depths down to approximately 3,200 metres. The farm-in included a significant amount of 2-D seismic, both on the joint venture land and over Crown acreage in the area. All prospects on the farm-in lands are considered medium-risk to high-risk with high-reward potential.

There is significant infrastructure in the area available through third parties. Action expects that its anticipated production growth will justify investing in additional operated infrastructure. Action committed to drill a total of five wells in the area in 2007 as the only condition of the joint venture agreement to completely earn all 50.25 sections. The Company has planned to drill one well on the West Calais block, one well on the Kleskun-Puskwaskau block, two wells on the McLeans Creek block and an additional well on the block of its choice.

West Calais

Action can earn 100 percent working interest in 15 sections (9,600 acres) within the West Calais block. This multi-zone area holds a mixture of sweet light oil, natural gas and liquids-rich natural gas exploration targets. Action's primary targets are liquids-rich natural gas in the Granite Wash Formation, with potential reserves of 5-10 bcf per successful well, and sweet light (38° API) crude oil in the Beaverhill Lake Formation, a prolific zone offering potential reserves of 0.5-1 mmboe per successful well. Action is also pursuing uphole Cretaceous natural gas targets with potential reserves of 1-2 bcf per successful well.

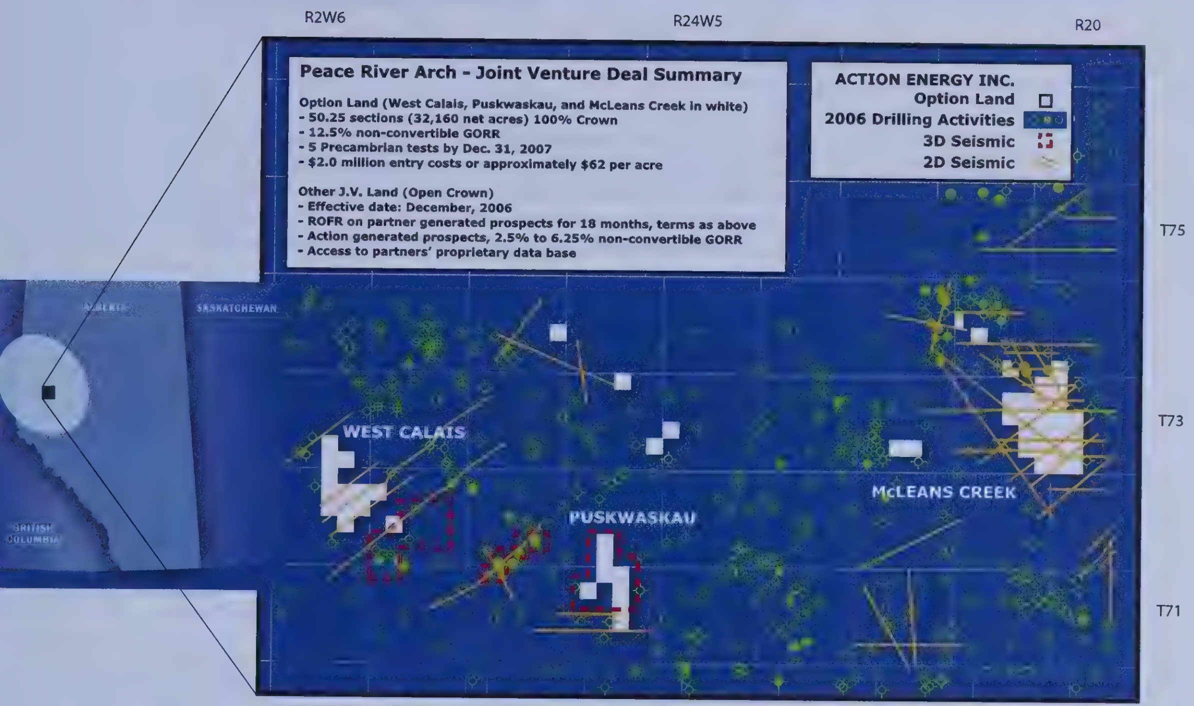
The Company has 10 square miles of 3-D seismic and 20 kilometres of 2-D seismic in the area. Action is committed to drilling one exploration well this year on the West Calais block pursuant to the terms of the farm-in agreement.

Kleskun-Puskwaskau

Action can earn 100 percent working interest in 10 sections (6,400 acres) within the Kleskun-Puskwaskau block. This block provides the Company with similar geological prospects and potential reserve size as the West Calais block. In Q1 2007, Action purchased five square miles of 3-D seismic over an offset multi-zone Beaverhill Lake oil and Granite Wash natural gas pool, which the Company believes is analogous to some of its prospects. Action intends to shoot additional 3-D seismic in the area in 2007. The Company has committed to drilling one exploration well targeting Beaverhill Lake oil and Granite Wash natural gas in Q1 2007. The well will earn the entire Kleskun-Puskwaskau block.

McLeans Creek

McLeans Creek's 25 sections of land make up almost half the total included in the Peace River Farm-in Agreement. Action acquired 60 kilometres of new 2-D seismic in 2006, which helped it to identify more than 20 drilling prospects in the area. In 2007 Action is committed to drilling two exploratory wells targeting sweet light (38° API) crude oil in the Gilwood Formation, earning 100 percent working interest on the entire 25-section block.



Quick Facts: West Calais		Kleskun-Puskwaskau	McLeans Creek
Land:	9,600 net acres	6,400 net acres	16,000 net acres
Year-end 2006 production:	Property acquired in December 2006, no production	Property acquired in December 2006, no production	Property acquired in December 2006, no production
Targets:	Action's primary targets are liquids-rich natural gas in the Granite Wash Formation and sweet light crude oil in the Beaverhill Lake Formation	Action's primary targets are liquids-rich natural gas in the Granite Wash Formation and sweet light crude oil in the Beaverhill Lake Formation	Action is targeting sweet light Gilwood Formation crude oil
2006 wells drilled:	n/a	n/a	n/a
2007 locations:	Action committed to drilling one well under the terms of its farm-in agreement	Action committed to drilling one well under the terms of its farm-in agreement	Action committed to drilling two wells under the terms of its farm-in agreement
Inventory:	Purchased 10 square miles of 3-D seismic and shot 20 kilometres of 2-D seismic in 2006 to identify targets	Action plans to shoot 11 square miles of 3-D seismic in 2007 to build drilling inventory	Action has identified 20 drilling prospects through 60 km of new and trade 2-D seismic

Reserves

The Company's reserve report as at December 31, 2006 was prepared by AJM Petroleum Consultants (AJM), an independent petroleum reservoir engineering firm. The reserves as at December 31, 2006 have been evaluated in accordance with National Instrument 51-101, Standards of Disclosure for Oil and Gas Activities. The following tables provide reconciliation between the two reserve reports on a gross basis (before deducting royalties and without including any royalty interest).

2006 Reconciliation of Gross Company Reserves by Principal Product

Forecast Prices and Costs

	Total Proved					Proved Plus Probable				
	Light Oil (mbbls)	Heavy Oil (mbbls)	Natural Gas (mmcf)	NGL (mbbls)	Oil[3] Equivalent (mboe)	Light Oil (mbbls)	Heavy Oil (mbbls)	Natural Gas (mmcf)	NGL (mbbls)	Oil[3] Equivalent (mboe)
December 31, 2005	0.0	0.0	13,822.8	0.0	2,303.8	0.0	0.0	42,405.0	0.0	7,067.5
Technical and economic revisions	(27.8)	89.1	(2,477.0)	4.2	(347.3)	(51.4)	128.2	(2,934.6)	15.9	(396.4)
Discoveries	170.6	0.0	182.8	5.5	206.6	262.5	0.0	374.8	7.9	332.8
Acquisitions	151.6	373.0	2,417.5	10.5	938.0	268.3	640.6	5,313.8	24.2	1,818.7
Production	(13.3)	(6.5)	(277.9)	(1.4)	(67.5)	(13.3)	(6.5)	(277.9)	(1.4)	(67.5)
December 31, 2006	281.1	455.6	13,668.3	18.8	3,033.6	466.1	762.3	44,881.1	46.5	8,755.1

Action's gross interest reserves at December 31, 2006 were 3,033.6 mboe total proved reserves and 8,755.1 mboe proved plus probable reserves. The technical revisions included in the reconciliation between year-end reserves from 2005 to 2006 were not as a result of technical revisions but as a result of commodity prices and different assumptions in operating costs between Action and High Plains Energy Inc., which Action acquired in November 2006. This difference in assumptions was previously determined at the time of acquisition and was reflected in the exchange value at the time of the acquisition.

Summary Of Oil and Gas Reserves (Canada)

Forecast Prices and Costs

Reserves Category	Gross[1] Reserves					Net[2] Reserves				
	Light Oil (mbbls)	Heavy Oil (mbbls)	Natural Gas (mmcf)	NGL (mbbls)	Oil[3] Equivalent (mboe)	Light Oil (mbbls)	Heavy Oil (mbbls)	Natural Gas (mmcf)	NGL (mbbls)	Oil[3] Equivalent (mboe)
Proved										
Proved producing	220.8	187.3	3,683.3	15.1	1,037.0	191.3	163.1	3,260.8	10.3	908.2
Proved non-producing	0.0	66.0	119.5	0.0	85.9	0.0	57.9	110.2	0.0	76.3
Total proved developed	220.8	253.3	3,802.8	15.1	1,122.9	191.3	221.0	3,371.0	10.3	984.5
Proved undeveloped	50.8	202.3	8,953.1	3.7	1,749.0	38.4	178.7	7,724.3	2.9	1,507.3
Total proved	271.6	455.6	12,755.9	18.8	2,872.0	229.7	399.7	11,095.3	13.2	2,491.8
Probable additional	176.5	306.7	30,676.6	27.7	5,623.6	149.2	264.3	25,830.4	19.4	4,737.9
Total proved plus probable	448.0	762.3	43,432.5	46.5	8,495.6	378.8	664.0	36,925.7	32.6	7,229.7

Summary of Oil and Gas Reserves (United States)

Forecast Prices and Costs

Reserves Category	Gross[1] Reserves					Net[2] Reserves				
	Light Oil (mbbls)	Heavy Oil (mbbls)	Natural Gas (mmcf)	NGL (mbbls)	Oil[3] Equivalent (mboe)	Light Oil (mbbls)	Heavy Oil (mbbls)	Natural Gas (mmcf)	NGL (mbbls)	Oil[3] Equivalent (mboe)
Proved										
Proved producing	9.6	0.0	893.6	0.0	158.5	10.1	0.0	893.6	0.0	159.0
Proved non-producing	0.0	0.0	18.8	0.0	3.1	0.0	0.0	18.8	0.0	3.1
Total proved developed	9.6	0.0	912.4	0.0	161.6	10.1	0.0	912.4	0.0	162.1
Proved undeveloped	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total proved	9.6	0.0	912.4	0.0	161.6	10.1	0.0	912.4	0.0	162.1
Probable additional	8.6	0.0	536.2	0.0	97.9	8.9	0.0	536.2	0.0	98.2
Total proved plus probable	18.1	0.0	1,448.6	0.0	259.5	18.9	0.0	1,448.6	0.0	260.3

Summary of Oil and Gas Reserves (Corporate)

Forecast Prices and Costs

Reserves Category	Gross[1] Reserves					Net[2] Reserves				
	Light Oil (mbbls)	Heavy Oil (mbbls)	Natural Gas (mmcf)	NGL (mbbls)	Oil[3] Equivalent (mboe)	Light Oil (mbbls)	Heavy Oil (mbbls)	Natural Gas (mmcf)	NGL (mbbls)	Oil[3] Equivalent (mboe)
Proved										
Proved producing	230.3	187.3	4,576.9	15.1	1,195.5	201.4	163.1	4,154.4	10.3	1,067.2
Proved non-producing	0.0	66.0	138.4	0.0	89.1	0.0	57.9	129.0	0.0	79.4
Total proved developed	230.3	253.3	4,715.3	15.1	1,284.6	201.4	221.0	4,283.4	10.3	1,146.6
Proved undeveloped	50.8	202.3	8,953.1	3.7	1,749.0	38.4	178.7	7,724.3	2.9	1,507.3
Total proved	281.1	455.6	13,668.3	18.8	3,033.6	239.7	399.7	12,007.8	13.2	2,653.9
Probable additional	185.0	306.7	31,212.8	27.7	5,721.5	158.0	264.3	26,366.5	19.4	4,836.2
Total proved plus probable	466.1	762.3	44,881.1	46.5	8,755.1	397.8	664.0	38,374.3	32.6	7,490.1

(1) "Gross" reserves means the total working interest and royalty interest share of the Company's remaining recoverable reserves before deductions of royalties payable to others.

(2) "Net" reserves means the Company's gross reserves less all royalties payable to others.

(3) "Oil Equivalent" amounts have been calculated using a conversion rate of six thousand cubic feet of natural gas to one barrel of oil. The use of boe may be misleading, particularly if used in isolation. This conversion ratio is based on an energy equivalency conversion method primarily applicable at the burner tip and is not intended to represent a value equivalency at the wellhead.

(4) Columns may not add due to rounding.

Net Present Value of Future Net Revenue of Oil and Gas Reserves (Canada)

Forecast Prices and Costs

Reserves Category	Before Future Income Tax Expenses and Discounted at (% per year)				
($000s)	0	5	10	12	15
Proved					
Developed producing	24,456.3	20,860.9	18,448.0	17,680.1	16,676.5
Developed non-producing	1,467.1	1,247.9	1,080.5	1,024.5	949.8
Undeveloped	33,096.8	25,360.1	19,801.0	18,002.6	15,652.6
Total proved	59,020.1	47,468.9	39,329.6	36,707.2	33,278.8
Probable	110,355.0	75,634.4	54,250.9	47,951.3	40,187.5
Total proved plus probable	169,375.1	123,103.3	93,580.4	84,658.4	73,466.4

Net Present Value of Future Net Revenue of Oil and Gas Reserves (United States)

Forecast Prices and Costs

Reserves Category	Before Future Income Tax Expenses and Discounted at (% per year)				
($000s)	0	5	10	12	15
Proved					
Developed producing	4,401.9	3,419.8	2,832.8	2,658.8	2,440.9
Developed non-producing	106.9	92.8	81.9	78.1	73.1
Undeveloped	0.0	0.0	0.0	0.0	0.0
Total proved	4,508.7	3,512.6	2,914.6	2,737.0	2,514.0
Probable	4,236.0	2,256.3	1,465.2	1,274.7	1,060.8
Total proved plus probable	8,744.7	5,768.9	4,379.8	4,011.7	3,574.8

Net Present Value of Future Net Revenue of Oil and Gas Reserves (Corporate)

Forecast Prices and Costs

Reserves Category	Before Future Income Tax Expenses and Discounted at (% per year)				
($000s)	0	5	10	12	15
Proved					
Developed producing	28,858.2	24,280.7	21,280.8	20,338.9	19,117.4
Developed non-producing	1,573.9	1,340.7	1,162.4	1,102.6	1,022.9
Undeveloped	33,096.8	25,360.1	19,801.0	18,002.6	15,652.6
Total proved	63,528.8	50,981.5	42,244.2	39,444.2	35,792.9
Probable	114,591.0	77,890.7	55,716.1	49,226.0	41,248.3
Total proved plus probable	178,119.8	128,872.2	97,960.3	88,670.1	77,041.2

Summary of AJM Petroleum Consultants' Pricing and Exchange Rate Assumptions

Forecast Prices and Costs

	Natural Gas		Crude Oil		NGL			
Year	NYMEX (US$/mcf)	AECO (Cdn$/mcf)	WTI @ Cushing (US$/bbl)	Edm Ref. ($/bbl)	Butane ($/bbl)	Propane ($/bbl)	Ethane ($/bbl)	Cdn/US$ Exchange Rate
2007	$7.80	$7.40	$65.00	$72.85	$58.30	$47.35	$21.30	0.880
2008	$8.40	$8.00	$69.35	$77.75	$62.20	$50.55	$23.10	0.880
2009	$8.30	$7.90	$70.75	$79.35	$63.50	$51.55	$22.80	0.880
2010	$8.50	$8.00	$69.00	$77.30	$61.85	$50.25	$23.10	0.880
2011	$8.65	$8.25	$67.10	$75.15	$60.10	$48.85	$23.85	0.880
2012	$8.85	$8.40	$66.25	$74.15	$59.30	$48.20	$24.30	0.880
2013	$9.00	$8.50	$67.55	$75.60	$60.50	$49.15	$24.60	0.880
2014	$9.20	$8.75	$68.90	$77.15	$61.70	$50.15	$25.35	0.880
2015	$9.35	$8.90	$70.30	$78.70	$62.95	$51.15	$25.80	0.880
2016	$9.55	$9.10	$71.70	$80.25	$64.20	$52.15	$26.40	0.880
2017	$9.75	$9.25	$73.15	$81.85	$65.50	$53.20	$26.85	0.880
2018	$9.95	$9.45	$74.60	$83.50	$66.80	$54.25	$27.45	0.880
2019	$10.15	$9.65	$76.10	$85.15	$68.10	$55.35	$28.05	0.880
2020	$10.35	$9.85	$77.60	$86.85	$69.50	$56.45	$28.65	0.880
2021	$10.55	$10.05	$79.15	$88.60	$70.90	$57.60	$29.25	0.880
2022	$10.75	$10.25	$80.75	$90.40	$72.30	$58.75	$29.85	0.880
2023	$11.00	$10.45	$82.35	$92.20	$73.75	$59.95	$30.45	0.880
2024	$11.20	$10.65	$84.00	$94.05	$75.25	$61.15	$31.05	0.880
2025	$11.45	$10.85	$85.70	$95.90	$76.70	$62.35	$31.65	0.880
2026	$11.65	$11.05	$87.40	$97.85	$78.30	$63.60	$32.25	0.880

All prices escalated at 2 percent per year after 2026.

All costs escalated at 2 percent per year from 2007.

Reserve Life Index

	Oil and NGL	Natural Gas	Combined boe (@ 6:1)
December 2006 production	409 bbl/d	2,025 mcf/d	746 boe/d
Total proved reserve life index (years)	5.1	18.5	11.1
Total proved plus probable reserve life index (years)	8.5	60.7	32.1

Finding And Development (F&D) Costs

The Company's F&D costs are reported using the methodology outlined in National Instrument 51-101, Standards of Disclosure for Oil and Gas Activities. Total costs include the reporting year's costs and the change in estimated future development costs from the previous year's report. The aggregate finding and development costs in each reporting period may not reflect total finding and development costs related to the reserve additions for that year. Reserves are converted to barrels of oil equivalent using a conversion rate of six thousand cubic feet of natural gas to one barrel of oil. This conversion ratio is based on an energy equivalency conversion method primarily applicable at the burner tip and is not intended to represent a value equivalency at the wellhead.

Total Proved Finding & Development Cost – per NI 51-101

	2006	2005	2004	Three-Year Total
Finding costs ($)				
Land	**518,675**	1,057,261	472,269	2,048,205
Seismic	**4,907,778**	–	–	4,907,778
Drilling and completions	**10,987,975**	259,388	4,632,680	15,880,043
Total finding costs ($)	**16,414,428**	1,316,649	5,104,949	22,836,026
Development costs ($)				
Equipping and re-completions	**2,494,932**	26,269	141,642	2,662,843
Facilities	**–**	871,112	1,861,686	2,732,798
Total development costs ($)	**2,494,932**	897,381	2,003,328	5,395,641
Change in future development costs ($)	**(14,698,500)**	8,360,500	25,238,000	18,900,000
Total costs used in F&D calculation ($)	**4,210,860**	10,574,530	32,346,277	47,131,667
Reserve additions (boe @ 6:1)	**206,600**	8,400	4,543,800	4,758,800
Finding and development costs ($/boe @ 6:1)	**20.38**	1,258.87	7.12	9.90

Total Proved Plus Probable Finding & Development Cost – per NI 51-101

	2006	2005	2004	Three-Year Total
Finding costs ($)				
Land	**518,675**	1,057,261	472,269	2,048,205
Seismic	**4,907,778**	–	–	4,907,778
Drilling and completions	**10,987,975**	259,388	4,632,680	15,880,043
Total finding costs ($)	**16,414,428**	1,316,649	5,104,949	22,836,026
Development costs ($)				
Equipping and re-completions	**2,494,932**	26,269	141,642	2,662,843
Facilities	–	871,112	1,861,686	2,732,798
Total development costs ($)	**2,494,932**	897,381	2,003,328	5,395,641
Change in future development costs ($)	**(8,695,200)**	22,194,200	60,101,000	73,600,000
Total costs used in F&D calculation ($)	**10,214,160**	24,408,230	67,209,277	101,831,667
Reserve additions (boe @ 6:1)	**332,800**	–	10,522,500	10,855,300
Finding and development costs ($/boe @ 6:1)	**30.69**	n/a	6.39	9.38

Total Proved Finding & Development Cost – per NI 51-101

All-in Including Future Development Costs, Acquisitions, Dispositions and Revisions

	2006	2005	2004	Three-Year Total
Finding costs ($)				
Land	**518,675**	1,057,261	472,269	2,048,205
Acquisition	**32,997,535**	–	–	32,997,535
Seismic	**4,907,778**	–	–	4,907,778
Drilling and completions	**10,987,975**	259,388	4,632,680	15,880,043
Total finding costs ($)	**49,411,963**	1,316,649	5,104,949	55,833,561
Development costs ($)				
Equipping and re-completions	**2,494,932**	26,269	141,642	2,662,843
Facilities	–	871,112	1,861,686	2,732,798
Total development costs ($)	**2,494,932**	897,381	2,003,328	5,395,641
Change in future development costs ($)	**(14,698,500)**	8,360,500	25,238,000	18,900,000
Total costs used in F&D calculation ($)	**37,208,395**	10,574,530	32,346,277	80,129,202
Reserve additions (boe @ 6:1)	**797,300**	(2,184,200)	4,543,800	3,156,900
Finding and development costs ($/boe @ 6:1)	**46.67**	n/a	7.12	25.38

Total Proved Plus Probable Finding & Development Cost – per NI 51-101

All-in Including Future Development Costs, Acquisitions, Dispositions and Revisions

	2006	2005	2004	Three-Year Total
Finding costs ($)				
Land	**518,675**	1,057,261	472,269	2,048,205
Acquisition	**32,997,535**	–	–	32,997,535
Seismic	**4,907,778**	–	–	4,907,778
Drilling and completions	**11,270,993**	259,388	4,632,680	15,880,043
Total finding costs ($)	**49,411,963**	1,316,649	5,104,949	55,833,561
Development costs ($)				
Equipping and re-completions	**2,494,932**	26,269	141,642	2,662,843
Facilities	**–**	871,112	1,861,686	2,732,798
Total development costs ($)	**2,494,932**	897,381	2,003,328	5,395,641
Change in future development costs ($)	**(8,695,200)**	22,194,200	60,101,000	73,600,000
Total costs used in F&D calculation ($)	**43,211,695**	24,408,230	67,209,277	134,829,202
Reserve additions (boe @ 6:1)	**1,755,100**	(3,399,200)	10,522,500	8,878,400
Finding and development costs ($/boe @ 6:1)	**24.62**	n/a	6.39	15.18

Net Asset Value

	December 31, 2006
Proved plus probable reserves (present value discounted @ 10 percent) ($000s)	97,960.3
Undeveloped land ($000s)[1]	16,321.9
Working capital, including debt ($000s)	(3,477.0)
Proceeds on exercise of warrants ($000s)	2,597.0
Proceeds on exercise of stock options ($000s)	16,920.4
Net asset value (fully diluted) ($000s)	130,322.6
Fully diluted shares (000s)	31,633.1
Net asset value per share ($)	4.11

(1) Undeveloped land is valued at $89.50 per acre.

Management's Discussion and Analysis

Set out below is management's discussion and analysis (MD&A) of the financial and operating results of Action Energy Inc. ("Action" or the "Company") as at December 31, 2006 and for the year then ended. This MD&A is dated as of May 12, 2007. It should be read in conjunction with the audited consolidated financial statements and the related notes for the year ended December 31, 2006, prepared in accordance with Canadian generally accepted accounting principles (GAAP).

Basis Of Presentation

As more fully described in note 3 to the accompanying audited consolidated financial statements, Action became a publicly traded entity following the completion of the Plan of Arrangement ("Arrangement") between Action and High Plains Energy Inc. ("High Plains") dated September 6, 2006 and effective November 20, 2006. The shares of the newly incorporated company were listed for trading on the TSX Venture Exchange on November 27, 2006, under the symbol AEC.V.

This Arrangement resulted in High Plains issuing common shares to Action shareholders resulting in the shareholders of Action holding approximately 82 percent of the issued and outstanding common shares of High Plains upon completion of the Arrangement. As a result, the Arrangement has been accounted for as a reverse takeover of High Plains by Action. The following MD&A presents information for Action as a private company for the period January 1, 2006 to November 20, 2006 plus Action as a public company, including 40 days of results with High Plains for the period November 21, 2006 to December 31, 2006. The comparative information for 2005 represents Action as a private company.

The accounts of the Company include those of High Plains and its wholly-owned subsidiaries Griffon Petroleum Inc. and Northern Gas Marketing Inc., both incorporated in the state of Montana in the United States.

The financial data presented has been prepared in accordance with Canadian GAAP. The reporting and measurement currency is the Canadian dollar.

Non-GAAP Measures

Within this MD&A, references are made to the terms "cash flow from operations" and "netback", both of which have widespread use in the oil and natural gas industry in Canada, but are non-GAAP terms. The Company uses these measures to help evaluate its performance. Management uses funds from operations to analyze operating performance and leverage and considers future cash flow from operations as an indication of the Company's ability to generate sufficient cash to fund future capital programs and repay debt. Funds from operations should not be considered an alternative to, or more meaningful than, cash flow from operations as presented in the financial statements and determined in accordance with GAAP. Funds from operations or funds from operations per share (basic and diluted) may not be comparable to similar terms reported by other companies. The Company presents funds from operations as cash from operating activities before the change in non-cash working capital. The presentation of funds from operations per share (basic and diluted) is calculated using the same methodology as earnings per share.

Management considers netbacks to be an important measure as it demonstrates the Company's profitability relative to the current commodity prices. The calculation of netback is equal to total revenue less transportation costs, royalties (including Crown royalties, gross overriding royalties and freehold royalties) and operating costs, calculated on a barrel of oil equivalent basis.

Boe Presentation

Barrels of oil equivalent (boe) may be misleading, particularly if used in isolation. A boe conversion ratio of six thousand cubic feet (mcf) of natural gas to one barrel (bbl) of crude oil, as used throughout this report, is based on an energy conversion method primarily applicable at the burner tip and is not intended to represent a value equivalency at the wellhead. Certain financial measurements are presented on a per boe basis; such measurements may not be consistent with those used by other companies.

Forward-looking Statements

Certain information regarding the Company set forth in this document, including management's assessment of future plans and operations, may constitute forward-looking statements under applicable securities law. Assessments of future plans and operations involve risks associated with oil and natural gas exploration, production, marketing and transportation such as loss of market, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other producers, and the ability to access sufficient capital from internal and external sources. Statements relating to "reserves" are deemed to be forward-looking statements as they involve the implied assessment based on certain estimates and assumptions that the reserves described can be profitably produced in the future. Actual results may differ materially from those anticipated in forward-looking statements. The reader is therefore cautioned not to place undue reliance on such forward-looking statements. All subsequent forward-looking statements, whether written or oral, attributable to the Company or persons acting on its behalf are expressly qualified in their entirety by these cautionary statements. The Company assumes no obligation to update forward-looking statements should circumstances or management's estimates or opinions change.

Action's management is responsible for the integrity of the information contained in this report and for the consistency between the MD&A and financial statements. In preparation of these statements, estimates are necessary to make a determination of future values for certain assets and liabilities. Management believes these estimates have been based on careful judgements and have been properly presented. The financial statements have been prepared using policies and procedures established by management and fairly reflect Action's financial position, results from operations and funds from operations.

Overview

Action is an independent, Alberta-based emerging exploration and production company that commenced trading on the TSX Venture Exchange (symbol: AEC.V) on November 27, 2006. The Company has assembled a portfolio of oil and natural gas properties providing a balanced growth profile. Action intends to create shareholder value through successful exploitation of repeatable, low-risk development opportunities, high-impact full-cycle exploration, and complementary strategic acquisitions, while maintaining a strong balance sheet.

Guidance and Outlook

Guidance for 2007 is provided below which includes the consolidated operations of the Company:

	2007 Average	2007 Exit
Production		
Conventional heavy oil (bbls/d)	423	770
Light oil (bbls/d)	269	300
Natural gas (mcf/d)	2,230	2,000
Total production (boe/d)	1,064	1,400
Cash flow ($000s)	9,800	13,900[1]
Cash flow per fully diluted share ($)	0.31	0.44[1]
Capital expenditures		
Exploitation ($000s)	15,900	
Exploration ($000s)	5,000	
Year-end debt ($000s)		7,100

[1] Annualized, based on estimated December 2007 production and prices.

Guidance includes the beneficial effects from anticipated operating cost reductions on the acquired properties as the Company has identified a number of optimization opportunities. In addition, the Company has in place a new credit facility with $19 million available to fund capital expenditures in excess of cash flow and year-end cash balances. The year-end debt to cash flow ratio is projected to be approximately 0.72:1. The Company continually monitors its cash flow, capital program and debt levels and makes adjustments where necessary.

Petroleum and Natural Gas Sales

	Three Months Ended December 31,			Year Ended December 31,		
	2006	2005	% Change	**2006**	2005	% Change
Petroleum and natural gas sales ($)	**1,719,183**	710,241	142	**3,603,918**	2,386,939	51

The final quarter of 2006 included 40 days of production and revenue from High Plains as the effective date of the reverse takeover by Action was November 20, 2006 (see note 3 to the consolidated financial statements), thereby increasing both the quarterly and annual results for the year ended December 31, 2006 in comparison to the same periods in 2005. Excluding the petroleum and natural gas sales from High Plains, the Company would have had an increase of 23 percent and 16 percent over the three and 12 months ended December 31, 2006, respectively, from the same periods in 2005. This increase was a result of the change in the Company's commodity mix associated with the light oil production from the non-operated Medicine River area.

The Company does not have any outstanding derivative instruments to hedge future commodity prices nor did it have any such instruments outstanding during the year ended December 31, 2006.

Average daily production	Three Months Ended December 31,			Year Ended December 31,		
	2006	2005	% Change	**2006**	2005	% Change
Natural gas (mcf/d)	**1,340**	727	84	**829**	822	1
Oil and NGL (bbls/d)	**179**	–	–	**75**	–	–
Total (boe/d @ 6:1)	**402**	121	232	**214**	137	56

Two-thousand six was the Company's first year for light oil production. It was generated from Action's participation in the non-operated Leduc play in the Medicine River area of central Alberta. Additional oil and NGL production was acquired effective November 20, 2006 with the reverse takeover of High Plains.

Realized prices	Three Months Ended December 31,			Year Ended December 31,		
	2006	2005	% Change	**2006**	2005	% Change
Natural gas ($/mcf)	**5.80**	10.62	(45)	**5.85**	7.96	(27)
Oil and NGL ($/bbl)	**61.10**	–	–	**67.07**	–	–
Combined average ($/boe @ 6:1)	**50.97**	63.70	(20)	**46.37**	47.76	(3)

Average benchmark prices	Three Months Ended December 31,			Year Ended December 31,		
	2006	2005	% Change	**2006**	2005	% Change
AECO-C ($/mcf)	**6.99**	11.63	(40)	**6.54**	8.71	(25)
WTI (US$/bbl)	**60.21**	60.02	–	**66.22**	56.56	(17)
Edmonton ($/bbl)	**64.49**	71.17	(9)	**72.77**	68.73	(6)

Royalties

	Three Months Ended December 31,			Year Ended December 31,		
	2006	2005	% Change	**2006**	2005	% Change
Royalties, net of ARTC ($)	**256,786**	75,348	241	**575,772**	273,780	110
As a percentage of revenue	**15**	11	36	**16**	11	45
Per unit of production ($/boe @ 6:1)	**6.94**	6.76	3	**7.40**	5.48	35

The Company pays Crown, freehold and gross overriding royalties to owners of the mineral rights from which production is generated, which were offset by Alberta Royalty Tax Credits (ARTC) until this program's expected cancellation beginning in 2007. Royalties vary on a property and product basis and those paid to the Crown are based on a sliding scale dependent on well productivity and commodity prices.

On an absolute dollar basis, royalties increased for both the three and 12 months ended December 31, 2006 over the same periods in 2005. The increases are a result of the combined increases in production volumes and sales revenue. There were increased gross overriding royalty burdens associated with the additional production from the non-operated Medicine River and from the newly acquired production from High Plains.

Operating Expenses

	Three Months Ended December 31,			Year Ended December 31,		
	2006	2005	% Change	**2006**	2005	% Change
Operating expenses ($)	**656,150**	288,804	127	**1,447,481**	1,056,709	37
Per unit of production ($/boe @ 6:1)	**17.74**	25.90	(32)	**18.61**	21.14	(12)

Action achieved reductions in its operating costs per unit of production for both the three months and year ended December 31, 2006 as the Company increased production over the same periods of 2005 and realized efficiencies in its operating cost structure. Operating costs in absolute dollar terms increased in both periods purely as a result of higher overall production. As part of its due diligence process on the High Plains acquisition, Action's management became aware of the higher operating costs associated with the properties being acquired and identified a number of opportunities for cost optimization. Management anticipates future operating cost decreases on a per boe basis as such optimization projects are completed.

General and Administrative (G&A) Expenses

	Three Months Ended December 31,			Year Ended December 31,		
	2006	2005	% Change	**2006**	2005	% Change
G&A expenses ($)	**1,600,349**	351,137	356	**2,905,800**	792,425	267
Per unit of production ($/boe @ 6:1)	**43.28**	31.50	37	**37.37**	15.86	136

G&A expenses have increased for both the three and 12 months ended December 31, 2006 as a result of hiring additional technical personnel, the declaration of bonuses, costs associated with office premises and increased professional consulting fees. The final quarter of the year also included year-end accruals related to the audit and reserve report. The Company increased to 11 full-time staff by the end of 2006 from four employees in 2005.

Stock-based Compensation

During the year ended December 31, 2006, the Company granted stock options and revised certain existing grants and terms of existing grants resulting in $4,026,846 in stock-based compensation expense and a corresponding credit to contributed surplus. The calculation of the fair value and related stock-based compensation, using the Black-Scholes option pricing model, was updated effective November 20, 2006 for the reverse takeover of High Plains (see note 3 to the consolidated financial statements) using the following assumptions: 60 percent volatility; 3.9 to 4.3 percent risk-free interest rate; no dividend yield; and an expected option life of three to five years.

Interest Expense and Interest Income

	Three Months Ended December 31,			Year Ended December 31,		
	2006	2005	% Change	**2006**	2005	% Change
Interest expense ($)	**54,769**	143,873	(62)	**169,685**	495,588	(66)
Per unit of production ($/boe @ 6:1)	**1.48**	12.90	(89)	**2.18**	9.92	(78)
Interest income ($)	**176,330**	906	19,362	**753,522**	8,059	9,250
Per unit of production ($/boe @ 6:1)	**4.77**	0.08	5,863	**9.69**	0.16	5,956

The Company had a convertible debenture in the amount of $4,008,500 outstanding until March 2006 which bore interest at 12 percent per annum. The retirement of this obligation early in 2006 eliminated the interest expense for the remainder of the year. High Plains had drawn $7.0 million on its line of credit at the time of the acquisition and as such the final quarter of 2006 incurred interest expense associated with this bank debt.

Interest income was significantly higher for both the three months and 12 months ended December 31, 2006 than in the same periods in the previous year as a result of the $35 million private placement that the Company completed in February 2006. The funds were invested throughout the year until they were needed for capital requirements, resulting in the increase in revenues.

Depletion, Depreciation and Accretion

	Three Months Ended December 31,			Year Ended December 31,		
	2006	2005	% Change	**2006**	2005	% Change
Depletion and depreciation ($)	**1,069,749**	123,485	766	**2,142,904**	533,243	302
Accretion ($)	**7,970**	8,878	(10)	**39,578**	32,137	23
Total ($)	**1,077,719**	132,363	714	**2,182,482**	565,380	286
Per unit of production ($/boe @ 6:1)	**29.14**	11.87	145	**28.06**	11.31	148

Depletion was significantly higher for both the three months and twelve months ended December 31, 2006 than in the comparable 2005 periods as a result of the increased capital spending in the year adding to the depletable base, the lack of assigned proved reserves associated with the capital spent and increased production for the period.

Accretion represents the change in the time value of the asset retirement obligation over the applicable period. The underlying obligation may be increased in a period based on new obligations incurred from the drilling of wells or construction of facilities, and can be decreased as a result of abandonment work undertaken that thereby reduces future obligations. Action's capital program during the 12-month period ended December 31, 2006, increased the underlying obligation by $168,681 and the Company acquired an additional obligation of $2,726,661 with the reverse takeover of High Plains.

Income Taxes

The future income tax liability reflects the net tax effects of the temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and their corresponding income tax bases. Future income tax arises, for example, as depletion and depreciation recorded against capital assets differs from claims under related tax pools and also when tax balances such as share issue costs and loss carry-forwards are recorded for tax purposes with no basis for accounting.

The Company has estimated resource pools and loss carry-forwards available of approximately $63.3 million. Included in this balance are non-capital losses which expire between 2008 and 2026.

Funds Used in Operations and Net Loss

	Three Months Ended December 31,			Year Ended December 31,		
	2006	2005	% Change	**2006**	2005	% Change
Funds used in operations ($)	**(652,256)**	(168,254)	288	**(752,108)**	(460,809)	63
Per unit of production ($/boe @ 6:1)	**(17.64)**	(15.09)	17	**(9.67)**	(9.22)	5
Per share ($)						
Basic	**(0.03)**	(0.02)	50	**(0.04)**	(0.04)	–
Diluted	**(0.03)**	n/a	–	**(0.04)**	n/a	–
Net loss ($)	**(2,455,078)**	(366,761)	569	**(6,901,197)**	(1,181,632)	484
Per unit of production ($/boe @ 6:1)	**(66.39)**	(32.90)	102	**(88.74)**	(23.64)	275
Per share ($)						
Basic	**(0.11)**	(0.03)	267	**(0.34)**	(0.11)	209
Diluted	**(0.11)**	n/a	–	**(0.34)**	n/a	–
Weighted-average number of shares						
Basic (000s)	**21,809**	10,503	108	**20,158**	10,433	93
Diluted (000s)	**21,809**	n/a	–	**20,158**	n/a	–

Note: Diluted shares outstanding not calculated for the historical period as the Company was private and no public share trading data was available.

Funds from operations for the three months and year ended December 31, 2006 decreased as a result of higher G&A for the year associated with the increased personnel staffing and additional costs in the final quarter for year-end expenses, such as the independent reserve report and annual financial statement audit.

Net loss for the three months and year ended December 31, 2006 increased mainly as a result of the stock-based compensation recorded for the period, totaling $4.0 million. Modifications in 2006 to the exercise prices and vesting periods resulted in $1.74 million being charged against income for the year while the granting of options during the period resulted in the remaining $2.26 million of stock-based compensation charged against income. In addition, the net loss was further impacted by higher depletion charges associated with the increased capital spending creating a larger depletable base being amortized over lower associated reserves.

The weighted average number of shares outstanding for the year ended December 31, 2006 was 20,157,836.

Capital Expenditures

	Three Months Ended December 31,			Year Ended December 31,		
	2006	2005	% Change	**2006**	2005	% Change
Land ($)	**188,524**	72,270	161	**518,675**	1,057,261	(51)
Acquisitions ($)	**32,997,535**	–	–	**32,997,535**	–	–
Drilling and completions ($)	**4,844,663**	19,089	25,279	**10,987,976**	259,388	4,136
Seismic ($)	**4,872,978**	–	–	**4,907,778**	–	–
Re-completions and equipping ($)	**1,203,674**	223	539,664	**2,494,932**	26,269	9,398
Facilities ($)	**–**	39,851	(100)	**–**	871,112	(100)
Administrative ($)	**46,881**	9,515	393	**221,342**	12,134	1,724
Total ($)	**44,154,255**	140,948	31,227	**52,128,238**	2,226,164	2,242

The final quarter of 2006 included the reverse takeover of High Plains, capital programs associated with the fulfillment of High Plains' flow-through obligations by December 31, 2006, and the acceleration of the Company's capital program planned for the first quarter of 2007 in the Lloydminster operating area. The Company was very active the rest of the year with the drilling of 16 shallow gas wells in the operating area of southwest Saskatchewan and the participation in drilling of two Leduc oil well discoveries in the Medicine River area of Alberta.

Liquidity and Capital Resources

The Company's working capital deficit at December 31, 2006 was $3,477,027 (December 31, 2005 – $5,078,736). This included the $6.0 million drawn on the Company's revolving operating demand loan facility with a financial institution which has an available funding of $19 million.

At December 31, 2006, the Company had 25,895,171 common shares outstanding (12,974,382 remained in escrow); 4,495,900 stock options outstanding with exercise prices ranging from $2.00 to $5.04 and expiration dates of November 2009 to December 2011; and 742,160 common share purchase warrants outstanding with an exercise price of $3.50 per warrant, all of which expired on April 14, 2007 without being exercised.

At May 11, 2007, the Company had 25,895,171 common shares outstanding (12,974,382 remained in escrow) and 4,700,000 stock options outstanding with exercise prices ranging from $2.00 to $5.04 and expiration dates of November 2009 to February 2012.

On April 11, 2007, the Company announced that it had entered into an agreement with a syndicate of investment bankers to raise $12 million through the issuance of 3,160,000 common shares on a flow-through basis, with an underwriters' option for an additional $3 million or 790,000 common shares on a flow-through basis. The Company anticipates closing this financing during the second quarter of 2007.

Related-party Transactions

A director and the corporate secretary of the Company are partners of a law firm that provides legal services to the Company. The services were conducted in the normal course of business operations and are measured at the exchange amount, which is established and agreed to by the parties based on standard rates, time spent and costs incurred. During the year ended December 31, 2006, the Company paid and accrued a total of $521,043 to this firm for legal fees and disbursements.

Contingency

As at December 31, 2006, there were several outstanding legal proceedings that had been previously filed against High Plains. The claims total approximately $950,000, the majority of which is anticipated to be settled through the swap of various joint properties. In addition, a claim in the amount of $3.4 million has been recently filed against the Company in regards to costs associated with a farm-out agreement. The Company has filed a counterclaim for unpaid amounts and funds from revenue are currently being held in trust.

The ultimate settlement of the disputes and amounts is dependent upon the outcome of future contingent events, the nature and likelihood of which cannot be determined at this time. The adjustment, if any, on resolution of this matter will be accounted for in the period of determination.

Selected Quarterly Data

The following tables provide selected quarterly information for Action:

	Three Months Ended December 31, 2006	Three Months Ended September 30, 2006	Three Months Ended June 30, 2006	Three Months Ended March 31, 2006
Production (boe/d)	402	250	90	107
Oil and natural gas sales ($)	1,719,183	1,213,826	271,676	399,233
Average realized price ($/boe)	50.97	52.76	33.18	41.60
Royalties ($/boe)	6.94	11.06	3.44	3.80
Operating expense ($/boe)	17.74	13.01	22.00	32.51
Field netback ($/boe)	26.29	28.70	7.74	5.29
Net G&A expense ($)	1,600,349	528,222	497,720	279,509
Cash flow from (used in) operations ($)	(652,256)	365,787	(174,462)	(291,177)
Per share (basic) ($)	(0.03)	0.02	(0.01)	(0.02)
Net income (loss) ($)	(2,455,078)	(2,396,602)	(528,583)	(1,520,934)
Per share (basic) ($)	(0.11)	(0.10)	(0.02)	(0.10)
Capital expenditures ($)	44,154,255	3,259,253	2,946,702	1,768,028
Working capital (deficit) (end of period) ($)	(3,477,027)	19,786,591	23,325,987	26,449,864

	Three Months Ended December 31, 2005	Three Months Ended September 30, 2005	Three Months Ended June 30, 2005	Three Months Ended March 31, 2005
Production (boe/d)	121	130	168	129
Oil and natural gas revenues ($)	710,241	616,054	619,451	441,193
Average realized price ($/boe)	63.70	51.57	40.47	38.10
Royalties ($/boe)	6.76	5.73	4.81	4.84
Operating expense ($/boe)	25.90	18.63	20.40	20.09
Field netback ($/boe)	31.04	27.14	15.26	13.17
Net G&A expense ($)	351,137	176,623	62,315	202,350
Cash flow from (used in) operations ($)	(168,254)	3,919	25,934	(322,408)
Per share (basic) ($)	(0.02)	0.00	0.00	(0.03)
Net income (loss) ($)	(366,761)	(142,095)	(155,963)	(464,469)
Per share (basic) ($)	(0.03)	(0.01)	(0.01)	(0.04)
Capital expenditures ($)	140,948	1,119	338,849	1,745,248
Working capital (deficit) (end of period) ($)	(5,078,736)	(4,936,024)	(4,881,404)	(4,568,489)

Contractual Obligations

In the course of its business, the Company enters into various contractual obligations, including the following:

- purchase of services;
- royalty agreements;
- operating agreements;
- processing agreements;
- right-of-way agreements; and
- lease obligations for accommodation, office equipment and automotive equipment.

The Company has approximate minimum commitments under its operating leases as follows:

2007	$ 151,182
2008	$ 155,892
2009	$ 148,360
2010	$ 148,360
2011	$ 37,090

Disclosure Controls and Procedures

The Company has implemented a system of internal controls that it believes adequately protects the assets of the Company and is appropriate for the nature of its business and the size of its operations. These internal controls include disclosure controls and procedures designed to ensure that information required to be disclosed by the Company is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosure. The Company's President and Chief Financial Officer have concluded, based on their evaluation as of December 31, 2006, that the disclosure controls and procedures are effective to provide reasonable assurance that material information related to the Company is made known to them except as noted below. It should be noted that while the Company's President and Chief Financial Officer believe that the Company's disclosure controls and procedures provide a reasonable level of assurance that the system of internal controls is sufficient, they do not guarantee that the disclosure controls and procedures will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the controls system are met.

Conclusion On Internal Controls Over Financial Reporting

The President and Chief Financial Officer of the Company are responsible for designing internal controls over financial reporting or causing them to be designed under their supervision in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. These officers have designed controls for this process and have conducted an evaluation which has identified certain weaknesses in the Company's controls. Due to the limited number of staff at the Company, there are inherent weaknesses in the system of internal controls due to its inability to achieve appropriate segregation of duties. The limited number of staff may also result in identifying weaknesses with respect to accounting for complex and non-routine accounting transactions as the Company does not have a sufficient number of finance personnel with technical accounting knowledge to address all complex and non-routine accounting matters that may arise. As a result of these weaknesses there is no guarantee that a material misstatement would not be prevented or detected. These items have been classified as material weaknesses. Reviews by management and the Board of Directors are utilized to mitigate the risk of material misstatement. Action currently has plans to hire additional staff to mitigate these weaknesses; however, the President and Chief Financial Officer do not have reasonable assurance that this risk can be reduced to a remote likelihood of a material misstatement.

Change in Accounting Policies

There have been no changes in accounting policies since the Company's last fiscal year-end. A comprehensive discussion of the Company's significant accounting policies is contained in note 2 to the consolidated financial statements.

New Accounting Pronouncements

The Accounting Standards Board of the Canadian Institute of Chartered Accountants (CICA) continually amends and improves certain standards or guidelines contained in the CICA Handbook. Action monitors these changes as they are proposed and will make changes to its accounting policies and disclosures as necessary.

Comprehensive Income

The CICA issued section 1530 of the CICA Handbook, Comprehensive Income. The section is effective for fiscal years beginning on or after October 1, 2006. It describes how to report and disclose comprehensive income and its components. An integral part of the accounting of the accounting standards on recognition and measurement of financial instruments is the ability to present certain gains and losses outside net income, in other comprehensive income. This standard requires that a company should present comprehensive income and its components in a financial statement displayed with the same prominence as other financial statements that constitute a complete set of financial statements, in both annual and interim financial statements.

The CICA also made changes to section 3250 of the CICA Handbook, Surplus, and re-issued it as section 3251, Equity. The section is also effective for fiscal years beginning on or after October 1, 2006. The changes in how to report and disclose equity and changes in equity are consistent with the new requirements of section 1530, Comprehensive Income.

Action will adopt this section effective January 1, 2007, but does not expect this section to have a material impact on its consolidated financial statements.

Financial Instruments – Recognition and Measurement

The CICA issued section 3855 of the CICA Handbook, Financial Instruments – Recognition and Measurement. The section is effective for fiscal years beginning on or after October 1, 2006. It describes the standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. This section requires that (i) all financial assets be measured at fair value, with some exceptions, such as loans and investments that are classified as held-to-maturity; (ii) all financial liabilities be measured at fair value if they are derivatives or classified as held for trading purposes (other financial liabilities are measured at their carrying value); and (iii) all derivative financial instruments be measured at fair value, even when they are part of a hedging relationship.

Action will adopt this section effective January 1, 2007, but does not expect this section to have a material impact on its consolidated financial statements.

Hedges

The CICA issued section 3866 of the CICA Handbook, Hedges. The section is effective for fiscal years beginning on or after October 1, 2006, and describes when and how hedge accounting can be used. Hedging is an activity used by a company to change an exposure to one or more risks by creating an offset between changes in the fair value of a hedged item and a hedging item; changes in the cash flows attributable to a hedged item and a hedging item; or changes resulting from a risk exposure relating to a hedged item and a hedging item. Hedge accounting ensures that all gains, losses, revenues and expenses from the derivative and the item it hedges are recorded in the income statement in the same period.

Action will adopt this section effective January 1, 2007, but does not expect this section to have a material impact on its consolidated financial statements.

Critical Accounting Estimates

The preparation of financial statements requires management to make judgments, assumptions and estimates in the application of GAAP that have a significant impact on the financial results of the Company. Actual results could differ from those estimates. The following is a discussion of the accounting estimates that are critical in determining the Company's financial results:

Full Cost Accounting

The Company follows the full cost method of accounting for oil and natural gas properties and equipment as prescribed by the CICA. Accordingly, all costs relating to the exploration for and development of oil and natural gas reserves are capitalized and accumulated in country-by-country cost centres. The capitalized costs and future capital costs related to each cost centre from which there is production are depleted on the unit-of-production method based on the estimated proved reserves of the cost centre in that country.

Certain costs related to unproved properties and major development projects may be excluded from costs subject to depletion until proved reserves have been determined or their value is considered to be impaired. Unproved properties are reviewed quarterly to determine if proved reserves have been established, at which point the associated costs are included in the depletion calculation.

The carrying amount of oil and natural gas properties in each cost centre may not exceed their recoverable amount ("the ceiling test"). The recoverable amount is calculated as the undiscounted cash flow using proved reserves and estimated future prices and costs. If the carrying amount of a cost centre exceeds it recoverable amount, then an impairment loss equal to the amount by which the carrying amount of the properties exceeds their fair value is charged against net earnings. Fair value is calculated as the cash flow from those properties using proved and probable reserves and expected future prices and costs, discounted at a risk-free interest rate. Proceeds on disposal of properties are ordinarily deducted from such costs without recognition of profit or loss except where such disposal constitutes a significant portion of the Company's reserves in that country.

Oil and Natural Gas Reserves

The proved crude oil, natural gas and natural gas liquids reserves used in determining depletion rates, the magnitude of the borrowing base available from a financial institution and the ceiling test are based on management's latest estimates and are subject to uncertainty and variability. Therefore, the Company retains qualified independent reserves evaluators to evaluate the Company's proved and probable oil and natural gas reserves. In 2006, 100 percent of the Company's reserves were evaluated by qualified independent reserves evaluators.

The estimation of reserves involves the exercise of judgment. Forecasts are based on engineering data, future prices, expected future rates of production and the timing of future capital expenditures, all of which are subject to many uncertainties and interpretations. The Company expects that over time its reserve estimates will be revised upward or downward based on updated information such as results of future drilling, testing and production levels. Reserve estimates can have a significant impact on net earnings, as they are a key component in the calculation of depletion, depreciation and amortization (DD&A). A revision to the reserve estimate could result in a higher or lower DD&A charge to net earnings. Downward revisions to reserve estimates could also result in a write-down of oil and natural gas property, plant and equipment carrying amounts under the ceiling test.

Asset Retirement Obligation

The fair value of asset retirement obligations related to long-term assets is recognized as a liability in the period in which the obligations are incurred. Retirement costs equal to the fair value of the asset retirement obligations are capitalized as part of the cost of associated capital assets and are amortized to expense through depletion over the life of the asset. The fair value of the asset retirement obligation is estimated by discounting the expected future cash flows to settle the asset retirement obligation at the Company's credit-adjusted risk-free interest rate. In subsequent periods, the asset retirement obligation is adjusted for the passage of time and for any changes in the amount or timing of the underlying future cash flows. Differences between actual and estimated costs to settle the asset retirement obligation, timing of cash flows to settle the obligation and future inflation rates could result in gains or losses on the settlement of the asset retirement obligations.

Stock-based Compensation

Options issued to employees and non-employees as part of compensation are accounted for using the fair value method of accounting for stock-based compensation. The fair value of the option is recognized as stock-based compensation expense and contributed surplus over the vesting period of the option. Stock-based compensation expense is determined on the date of an option grant using the Black-Scholes option pricing model. The Black-Scholes pricing method requires the estimation of several variables including estimated volatility of the Company's stock price over the life of the option, estimated option forfeitures, estimated life of the option, estimated risk-free rate and estimated dividend rate. A change to these estimates would alter the valuation of the option and would result in a different related stock-based compensation expense.

Business Risks

There are numerous risks facing participants in the Canadian oil and natural gas industry. Some of the risks are common to all businesses, while others are specific to the sector. The following reviews the business risks faced by Action:

Exploration

Exploration requires sophisticated and scarce technical skills as well as capital to generate and test exploration ideas and the drilling of an exploratory prospect frequently does not result in the discovery of economical reserves. Action endeavours to minimize exploration or finding risk by ensuring that:

- where possible, prospects have multi-zone potential;
- activity is focused in core regions where expertise and experience can be leveraged;
- prospects are internally generated;
- the Company serves as operator where possible; and
- geophysical techniques such as seismic are utilized where appropriate.

Capital Program

The Company's field investment program recognizes the need to ensure capital expenditures accommodate two objectives, those being immediate cash flow from development activities and future cash flow from the discovery of reserves through exploration. All investments have to recognize that the Company faces constant production declines from existing wells which have to be replaced by new production. The Company focuses its activity in core areas, which allows it to benefit from its experience and knowledge. The Company attempts to use farm-outs to minimize risk on plays it considers higher risk or where total capital invested exceeds acceptable levels.

Reserves Estimates

Estimates of economically recoverable oil and natural gas reserves and natural gas liquids and related future net cash flows are based upon a number of variable factors and assumptions such as commodity prices, production from the properties, future operating costs and potential changes to the Company's operations arising from regulatory amendments. All of these estimates may vary from actual results. Estimates of the recoverable oil and natural gas reserves attributable to any property vary. The Company's actual production, revenues, royalties and other taxes, and development and operating expenditures with respect to its reserves may vary from such estimates, and such variances may be material.

The Company's independent engineering firm, AJM Petroleum Consultants, completes an evaluation of the Company's reserves each year and reports to the Company's Reserves Committee.

Production

There is a risk that the Company's oil and natural gas reserves cannot be economically produced at prevailing prices. Action attempts to mitigate this risk by focusing on high-netback commodities and tries to operate its properties where possible, which allows the Company to manage costs, timing, method and marketing of production. Production risk is also addressed by concentrating exploration and development efforts in regions where infrastructure is readily accessible.

Environmental and Safety Risks

Oil and natural gas exploration and extraction pose considerable environmental risk and worksite practices must recognize the safety risks associated with heavy equipment and potentially volatile liquids and gases. Accordingly, Action has developed and implemented policies and procedures to mitigate environmental, health and safety risks. These policies and procedures include the use of formal corporate policies, emergency response plans and other policies and procedures reflecting best oilfield practices. These policies and procedures are designed to protect and maintain the environment and to enhance public and employee safety. The Company mitigates environmental and safety risks by maintaining its facilities to a high standard, complying with all provincial and federal environmental and safety regulations and maintaining appropriate insurance coverage.

Competitive Industry Conditions

The Canadian oil and natural gas industry is highly competitive. Demand for oil and natural gas properties, undeveloped land, drillable prospects and qualified staff remains strong at present due to commodity prices, particularly of crude oil. The Company has a large undeveloped land base that provides an inventory of exploration prospects. In addition, the Company attempts to mitigate the risk of a lack of drillable prospects by developing its own exploration prospects, thus building an inventory of prospects that supports future growth.

Availability of Services and Equipment

The availability of service and production equipment at competitive prices is vital to the Company's ability to add reserves at a competitive cost and to profitably produce these reserves. In periods of increased activity, as experienced in recent years, services and equipment can become difficult to obtain. The Company attempts to mitigate this risk by developing strong long-term relationships with suppliers and contractors.

Financial and Liquidity Risks

The Company relies on various sources of funding to support its growing capital expenditure program, including:

- internally generated cash flows, which provide the initial source of funding on which the Company's annual capital expenditure program is based;
- debt, which may be utilized to expand capital programs, including acquisitions, when it is deemed appropriate;
- new equity, including flow-through shares, if available and on favourable terms, may be utilized to expand acquisition programs; and
- farm-outs of projects may be arranged if management considers that a project requires too much capital or where the project affects the Company's risk profile. In addition, farm-ins are employed to gain access to existing mineral leases and geological data, allowing Action to focus its capital expenditures on the drilling and completions phases.

Funds from operations is influenced by many factors which the Company may not control, such as commodity prices, exchange rates, interest rates and changes to existing government regulations and tax policies.

Marketing Risks

Crude oil prices are affected by worldwide supply and demand fundamentals, while natural gas prices are affected by supply and demand dynamics within North America. The Company attempts to mitigate these risks by developing natural gas properties in areas where there is suitable pipeline infrastructure, by diversifying its exploration efforts to include higher-netback oil reserves, and by using financial instruments where appropriate to manage commodity price volatility where the Company has funded capital assets, including acquisitions, whose cost exceeds near-term projected cash flows.

Additional Information

Additional information relating to Action Energy Inc. is available on SEDAR at www.sedar.com.

Management's Report to the Shareholders

The accompanying consolidated financial statements and all information in the annual report are the responsibility of management. The consolidated financial statements have been prepared by management in accordance with the accounting policies in the notes to the consolidated financial statements. Where necessary, management has made informed judgments and estimates in accounting for transactions affecting the current period, but dependent on information not known with certainty until a future period. In the opinion of management, the consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles appropriate in the circumstances. The financial information elsewhere in the annual report has been reviewed to ensure consistency with that in the consolidated financial statements.

Management maintains appropriate systems of internal controls. Policies and procedures are designed to give reasonable assurance that transactions are appropriately authorized, assets are safeguarded from loss or unauthorized use and financial records are properly maintained to provide reliable information for preparation of financial statements. The consolidated financial statements have been prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized in the notes to the consolidated financial statements.

KPMG LLP, an independent firm of chartered accountants, has been engaged, as approved by a vote of the shareholders, to examine the consolidated financial statements in accordance with generally accepted auditing standards in Canada and provide an independent professional opinion. Its report is presented with the consolidated financial statements.

The Board of Directors (the "Board") is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal controls. The Board exercises this responsibility through the Audit Committee of the Board. This committee meets with management and the external auditors to satisfy itself that management's responsibilities are properly discharged and to review the consolidated financial statements before they are presented to the Board for approval. The consolidated financial statements have been approved by the Board on the recommendation of the Audit Committee.

(Signed) "R.D. (Bob) Bowman"

R.D. (Bob) Bowman

President and Chief Operating Officer

May 12, 2007

Auditors' Report

To the Shareholders of

Action Energy Inc.

We have audited the consolidated balance sheets of Action Energy Inc. as at December 31, 2006 and 2005 and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Calgary, Canada

May 12, 2007

(Signed) "KPMG LLP"

Chartered Accountants

Consolidated Balance Sheets

As at December 31,	2006	2005
Assets		
Current assets:		
Cash and cash equivalents	$ 10,236,601	$ 434,861
Accounts receivable	4,068,559	429,552
Prepaid expenses	437,944	87,090
	14,743,104	951,503
Property and equipment (note 4)	75,540,902	25,667,970
	$ 90,284,006	$ 26,619,473
Liabilities		
Current liabilities:		
Accounts payable and accrued liabilities	$ 12,220,131	$ 640,010
Bank debt (note 5)	6,000,000	1,392,198
Convertible debt (note 6)	–	3,998,031
	18,220,131	6,030,239
Asset retirement obligation (note 7)	3,496,205	861,343
Future income taxes (note 8)	2,442,757	–
	24,159,093	6,891,582
Shareholders' equity:		
Share capital (note 9)	72,674,796	23,406,245
Contributed surplus (note 10)	4,272,220	158,802
Equity portion of convertible debt (note 6)	–	83,750
Deficit	(10,822,103)	(3,920,906)
	66,124,913	19,727,891
	$ 90,284,006	$ 26,619,473
Commitments (note 12)		
Contingencies (note 15)		
Subsequent events (note 17)		

See accompanying notes to the consolidated financial statements.

On behalf of the Board:

(Signed) "Andrew J. Byrne" (Signed) "Scott Soler"

Andrew J. Byrne, Director Scott Soler, Director

Consolidated Statements of Operations and Deficit

Years ended December 31,	2006	2005
Revenues:		
Petroleum and natural gas sales	$ 3,603,918	$ 2,386,939
Royalties, net of Alberta Royalty Tax Credit	(575,772)	(273,780)
	3,028,146	2,113,159
Other income	753,522	8,059
	3,781,668	2,121,218
Expenses:		
Operating	1,447,481	1,056,709
General and administrative	2,905,800	792,425
Stock-based compensation	4,026,846	82,162
Interest	169,685	495,588
Accretion on convertible debt (note 6)	10,469	73,281
Financing fees (note 6)	–	184,962
Depletion and depreciation	2,142,904	533,243
Accretion	39,578	32,137
Foreign exchange gain	(8,165)	–
	10,734,598	3,250,507
Loss before income taxes	(6,952,930)	(1,129,289)
Income taxes (note 8)		
Capital taxes	–	52,343
Future income tax reduction	(51,733)	–
Net loss	(6,901,197)	(1,181,632)
Deficit, beginning of year	(3,920,906)	(2,739,274)
Deficit, end of year	$ (10,822,103)	$ (3,920,906)
Net loss per share (note 9(g))		
Basic and diluted	$ (0.34)	$ (0.11)

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Cash Flows

Years ended December 31,		2006		2005
Operating activities				
Net loss	$	(6,901,197)	$	(1,181,632)
Items not involving cash:				
Other income		(7,215)		–
Stock-based compensation		4,026,846		82,162
Accretion on convertible debt		10,469		73,281
Depreciation and depletion		2,142,904		533,243
Accretion		39,578		32,137
Future income taxes		(51,733)		–
Abandonment expenditures (note 7)		(11,760)		–
		(752,108)		(460,809)
Changes in non-cash working capital (note 11)		(320,307)		655,962
		(1,072,415)		195,153
Financing activities				
(Repayment of) proceeds from bank debt		(2,292,198)		719,290
(Repayment of) proceeds from convertible debt		(3,793,000)		4,008,500
Issuance of shares, net of share issue costs		33,344,563		237,271
Advances receivable		(778,028)		–
Changes in non-cash working capital (note 11)		(60,622)		60,622
		26,420,715		5,025,683
Investing activities				
Expenditures on property and equipment		(19,130,703)		(2,281,084)
Bank indebtedness acquired (note 3)		(56,077)		–
Transaction costs (note 3)		(928,533)		–
Changes in non-cash working capital (note 11)		4,568,753		(2,504,891)
		(15,546,560)		(4,785,975)
Increase in cash and cash equivalents		9,801,740		434,861
Cash and cash equivalents, beginning of year		434,861		–
Cash and cash equivalents, end of year	$	10,236,601	$	434,861
Supplemental cash flow information				
Interest paid	$	169,685	$	434,966
Income taxes paid		–		102,182

See accompanying notes to the consolidated financial statements.

Notes to the Consolidated Financial Statements

1. Nature of operations

Action Energy Inc. ("Action" or the "Company") is incorporated under the Business Corporations Act (Alberta) and is engaged in the exploration, development and production of petroleum and natural gas in western Canada and the United States.

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries which were acquired through the business combination described in note 3.

2. Significant accounting policies

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Since the determination of many assets, liabilities, revenues and expenses is dependent upon future events, the preparation of these consolidated financial statements requires the use of estimates and assumptions, which have been made with careful judgment. In the opinion of management, these consolidated financial statements have been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized below.

a) Cash and cash equivalents

Cash and cash equivalents consist of bank balances and term deposits with original maturities of three months or less.

b) Property and equipment

i) Capitalized costs

The Company follows the full cost method of accounting for its petroleum and natural gas operations. Under this method all costs related to the exploration for and development of petroleum and natural gas reserves are capitalized. Costs include lease acquisition costs, geological and geophysical expenses and costs of drilling both productive and non-productive wells. Proceeds from the sale of properties are applied against capitalized costs, without any gain or loss being realized, unless such sale would alter the rate of depletion and depreciation by more than 20 percent.

ii) Depletion and depreciation

Depletion of petroleum and natural gas properties and depreciation of production equipment, net of estimated salvage or residual value, is provided using the unit-of-production method based upon estimated gross proved petroleum and natural gas reserves as determined by independent engineers. The costs of significant unevaluated properties are excluded from costs subject to depletion. These properties are assessed periodically to ascertain whether impairment has occurred. For depletion and depreciation purposes, relative volumes of petroleum and natural gas production and reserves are converted at the energy equivalent conversion rate of six thousand cubic feet of natural gas to one barrel of crude oil.

Office equipment is depreciated over its estimated useful life at declining balance rates between 20 percent and 50 percent.

iii) Ceiling test

In applying the full cost method, the Company calculates a ceiling test whereby the carrying amount of property and equipment is compared to the sum of the undiscounted cash flows expected to result from the future production of proved reserves and the sale of unproved properties. Cash flows are based on third party quoted forward prices, adjusted for transportation and quality differentials. Should the ceiling test result in an excess of carrying amount, the Company would then measure the amount of impairment by comparing the carrying amounts of property and equipment to an amount equal to the estimated net present value of future cash flows from proved plus probable reserves and the sale of unproved properties. The Company's risk-free interest rate is used to arrive at the net present value of the future cash flows. Any excess carrying amount would be recorded as impairment and included in depletion and depreciation.

c) Asset retirement obligations

The Company recognizes the fair value of a liability for an asset retirement obligation in the period in which it is incurred and records a corresponding increase in the carrying amount of the related long-lived asset. The fair value is determined through a review of engineering studies, industry guidelines, and management's estimate on a site-by-site basis. The liability is subsequently adjusted for the passage of time, and is recognized as an accretion expense in the statement of operations. The liability is also adjusted due to revisions in either the timing or the amount of the original estimated cash flows associated with the liability. The increase in the carrying amount of the asset is amortized using the unit-of-production method based on estimated gross proved reserves as determined by independent engineers. Actual costs incurred upon settlement of the asset retirement obligations are charged against the asset retirement obligation to the extent of the liability recorded. Any difference between the actual costs incurred upon settlement of the asset retirement obligations and the recorded liability is recognized as a gain or loss in the Company's statement of operations in the period in which the settlement occurs.

d) Future income taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on temporary differences between the accounting basis and the tax basis of assets and liabilities and are measured using substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. A valuation allowance is recorded against a future income tax asset if it is more likely than not that the asset will not be realized.

e) Convertible debt

Convertible debt is recorded at the amount of proceeds received less the amount attributed to the conversion feature which is included as part of shareholders' equity. As the debt is converted, a portion of debt and equity amounts is transferred to share capital. The debt balance associated with the convertible debt accretes over time to the amount owing on maturity and such increases in the debt balance are reflected as non-cash interest expense in the statement of operations.

f) Stock-based compensation

Under the Company's stock option plan described in note 9, options to purchase common shares are granted to directors, officers, employees and consultants at current market prices or higher. Stock-based compensation expense is based on the estimated fair value of options granted at the time of the grant. The fair value is recognized in current earnings as stock-based compensation expense with a corresponding increase to contributed surplus over the vesting period of the options. Stock-based compensation for options granted to directors and employees is based on the estimated fair value at the time of the grant. Stock-based compensation for options granted to consultants is based on the estimated fair value at each balance sheet date until the related options are fully vested. Upon the exercise of the stock options, consideration paid together with the amount previously recognized in contributed surplus is recorded as an increase in share capital. In the event that vested options expire, previously recognized compensation expense associated with such stock options is not reversed. In the event that unvested options are forfeited, previously recognized compensation expense associated with such stock options is reversed.

g) Flow-through shares

Share capital includes flow-through shares issued pursuant to certain provisions of the Income Tax Act (Canada) (the "Act"). The Act provides that, where the share issuance proceeds are used for qualified exploration and development expenditures, the related income tax deduction may be renounced to subscribers. Accordingly, these expenditures provide no income tax deduction to the Company. Share capital is reduced and a future income tax liability is recorded for the estimated future tax cost of the renounced expenditures, on the date that the Company files the renouncement documents with the tax authorities.

h) Per share amounts

The treasury stock method of calculating diluted per share amounts is used whereby any proceeds from the exercise of in-the-money stock options or warrants are assumed to be used to purchase, for cancellation, common shares of the Company at the average market price during the year. Basic loss per share is computed by dividing net loss by the weighted-average number of common shares outstanding during the year. Diluted per share amounts reflect the potential dilution that could occur if stock options or warrants to purchase common shares were exercised and converted to common shares.

i) Foreign currency translation

The Company's foreign subsidiaries are considered financially and operationally integrated. Consequently, the temporal method of translation of foreign currencies is followed. Therefore, all gains and losses arising from the translation of the financial statements of these foreign subsidiaries are included in earnings.

Monetary items denominated in a foreign currency are translated into Canadian dollars at the rate of exchange in effect at the balance sheet date and non-monetary items are translated at rates of exchange in effect when the assets were acquired or obligations incurred. Revenues and expenses are translated at rates in effect at the time of the transactions. Foreign exchange gains and losses are included in earnings.

j) Revenue recognition

Petroleum and natural gas sales are recognized in earnings when reserves are produced and delivered to the purchaser. Interest income is recognized as earned.

k) Joint operations

Substantially all of the exploration and production activities of the Company are conducted jointly with others and these consolidated financial statements reflect only the Company's proportionate interest in such activities.

l) Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. The amounts recorded for depletion and depreciation of property and equipment and the provision for asset retirement obligations and the ceiling test are based on estimates of gross proved reserves, production rates, oil and gas prices, future costs and other relevant assumptions. These estimates are reviewed regularly and changes in such estimates in future years could be significant. As adjustments become necessary, they are reported in earnings in the periods in which they become known.

3. Business combination

Effective November 20, 2006, pursuant to the Arrangement Agreement (the "Arrangement") dated September 6, 2006, a wholly-owned subsidiary of High Plains Energy Inc. ("High Plains") was amalgamated with Action to form Amalco. Each issued and outstanding share of Action was exchanged for 2.5 common shares of High Plains and each outstanding unexercised stock option of Action was exchanged for an option to purchase 2.5 common shares of High Plains. The issued and outstanding shares, options and warrants of High Plains were then consolidated on the basis of one common share, warrant or stock option of High Plains for each five outstanding common shares, warrants or stock options, after which time High Plains and Amalco were amalgamated and now carry on business under the name of Action Energy Inc.

The Arrangement was an arm's-length transaction resulting in the shareholders of Action owning approximately 82 percent of the issued and outstanding common shares of High Plains upon completion of the Arrangement. As a result, the Arrangement has been accounted for as a reverse takeover acquisition of High Plains by Action using the purchase method with Action deemed the acquirer.

In accordance with reverse takeover accounting, these consolidated financial statements are a continuation of Action with the results of operations of High Plains included in the accounts from the effective date of the Arrangement.

The allocation of the purchase price based on management's best estimates of fair values as at the date of acquisition is as follows:

Net assets acquired		
Current assets	$	2,081,681
Property and equipment		32,997,535
Bank debt		(6,956,077)
Other current liabilities		(5,541,208)
Asset retirement obligation		(2,726,661)
Future income tax liability		(2,988,678)
Due to Action Energy Inc.		(720,937)
	$	16,145,655

Consideration		
4,545,207 common shares	$	14,917,122
Transaction costs, including 70,600 Action common shares for a total of $300,000		1,228,533
	$	16,145,655

4. Property and equipment

				December 31, 2006 Accumulated depletion and depreciation		
		Cost				Net
Petroleum and natural gas properties	$	78,905,963	$	3,710,757	$	75,195,206
Office equipment		448,428		102,732		345,696
	$	79,354,391	$	3,813,489	$	75,540,902

				December 31, 2005 Accumulated depletion and depreciation		
		Cost				Net
Petroleum and natural gas properties	$	27,260,106	$	1,619,000	$	25,641,106
Office equipment		78,450		51,586		26,864
	$	27,338,556	$	1,670,586	$	25,667,970

Unproved property costs amounting to approximately $1,187,800 were excluded from costs subject to depletion (2005 – $1,543,400). Future development costs totalling $18.9 million (2005 – $26.0 million) were included and estimated salvage values of $2,178,155 (2005 – $2,297,600) were excluded from the depletion calculation. The Company did not capitalize any general and administrative expenses in 2006 and 2005.

The carrying amount of the Company's petroleum and natural gas properties is limited to the amount calculated under the ceiling test at the balance sheet date. The ceiling test calculation was based on benchmark reference prices indicated below:

	Foreign Exchange Rate (US$/Cdn$)	Edmonton Light Crude Oil ($ per bbl)	AECO Gas ($ per mcf)
2007	0.880	72.85	7.40
2008	0.880	77.75	8.00
2009	0.880	79.35	7.90
2010	0.880	77.30	8.00
2011	0.880	75.15	8.25

Oil and gas prices escalate at 2 percent per annum after 2011.

5. Bank debt

The Company has a revolving operating demand loan with a financial institution for a maximum of $19,000,000, of which $6,000,000 was drawn as at December 31, 2006. The amount outstanding bears interest at a rate per annum of the financial institution's prime rate. The loan is secured by a general security agreement providing coverage over all present and subsequently acquired property of the Company and a $50 million debenture.

6. Convertible debt

In February 2005, the Company arranged a $4,008,500 subordinated credit facility by way of a convertible promissory note. The promissory note was convertible at the option of the lender into 2,672,347 common shares with a conversion price of $1.50 per share. The promissory note had an interest rate of 12 percent per annum and was secured by a $5,000,000 fixed and floating debenture over all of the Company's assets. The maturity of the promissory note was February 15, 2006 which was extended to March 2006.

The liability component of the convertible promissory note was estimated at $3,924,750 based on the present value of principal and interest with the residual amount of $83,750 ascribed to the equity component. Over the term of the promissory note, the debt portion was accreted up to the principal amount of $4,008,500.

In March 2006, the Company settled the convertible debt for total consideration of $4,005,678 consisting of a cash payment of $3,793,000 and the conversion of $212,678 into 70,893 post-consolidation common shares of the Company at $3.00 per share (141,785 pre-consolidation common shares at $1.50). The $86,572 difference between the settlement consideration and the sum of the liability and equity components has been recorded to contributed surplus.

The Company incurred $184,962 of financing fees in 2005 to secure this promissory note.

7. Asset retirement obligation

The following table presents the reconciliation of the carrying amount of the obligation associated with the retirement of the Company's property and equipment:

	2006	2005
Asset retirement obligation, beginning of year	$ 861,343	$ 779,166
Liabilities incurred	168,681	90,074
Liabilities acquired (note 3)	2,726,661	–
Revisions	(288,298)	(40,034)
Abandonment expenditures	(11,760)	–
Accretion	39,578	32,137
Asset retirement obligation, end of year	$ 3,496,205	$ 861,343

The following significant assumptions were used to estimate asset retirement obligations:

	2006	2005
Undiscounted cash flows	$ 5,820,716	$ 1,586,300
Credit-adjusted discount rate, adjusted for inflation	8%	8%
Expected timing of cash flows	10.2 years	14.5 years

8. Income taxes

The provision for income taxes differs from the amount computed by applying the combined federal and provincial tax rates to the loss before income taxes. The difference results from the following:

	2006	2005
Expected income tax reduction at 35.79% (2005 – 40.37%)	$ (2,489,412)	$ (426,310)
Crown royalties	2,009	24,904
Resource allowance	28,434	(24,333)
Non-deductible items	1,461,268	40,991
Capital taxes	–	52,343
Rate adjustments and other	138,779	(202,684)
Change in valuation allowance	807,189	587,432
	$ (51,733)	$ 52,343

The components of the net future income tax liability are as follows:

	2006	2005
Asset retirement obligations	$ 1,037,747	$ 313,270
Non-capital losses	856,527	589,312
Share issue costs	471,479	4,107
Property and equipment	(4,808,510)	(37,983)
Valuation allowance	–	(868,706)
	$ (2,442,757)	$ –

As at December 31, 2005, the Company had approximately $2.9 million of non-capital losses which expire between 2008 and 2026.

9. Share capital

a) Authorized

Unlimited number of voting common shares.
Unlimited number of preferred shares, issuable in series.

b) Issued

All common share figures included herein are on a post-consolidation basis. See note 3.

Common shares	Number	Amount
Balance, December 31, 2004	10,410,160	$ 23,168,974
Flow-through private placement (i)	92,593	250,000
Share issue costs	–	(12,729)
Balance, December 31, 2005	10,502,753	23,406,245
Private placement (ii)	10,705,718	35,328,001
Debt conversion (note 6)	70,893	212,678
Transaction costs (note 3)	70,600	300,000
Share issue costs, net of $585,112 tax (ii)	–	(1,398,325)
Tax effect of flow-through shares (i)	–	(90,925)
	21,349,964	57,757,674
Issued to Action shareholders (note 3)	21,349,964	–
Issued to High Plains shareholders (note 3)	4,545,207	14,917,122
Balance, December 31, 2006	25,895,171	$ 72,674,796

i) In October 2005, the Company issued 92,593 flow-through shares at $2.70 per share to a director and officer of the Company for gross proceeds of $250,000. The $90,925 tax effect of the flow-through proceeds was recorded in February 2006 when the related tax benefits were renounced to investors.

ii) Pursuant to a private placement in February 2006, the Company issued 10,705,718 common shares at $3.30 per share for gross proceeds of $35,328,001. In conjunction with the private placement, the Company incurred $1,983,437 of commissions and fees.

c) Stock options

The Company has a stock option plan for its directors, officers, employees and consultants. Pursuant to the plan, the number of shares reserved for issuance pursuant to the exercise of all options under the plan may not exceed 4,700,000 common shares. Options expire not more than five years from the date of grant, or earlier if the individual ceases to be associated with the Company, and vest at the discretion of the Board of Directors.

The following is a continuity of the Company's stock options presented on a post-consolidated basis (see note 3):

	2006		2005	
	Number of options	**Weighted-average exercise price**	Number of options	Weighted-average exercise price
Balance, beginning of year	**1,030,608**	**$ 2.14**	944,839	$ 2.22
Granted	**3,465,292**	**4.22**	192,522	2.00
Cancelled	**–**	**–**	(106,753)	2.50
Balance, end of year	**4,495,900**	**$ 3.76**	1,030,608	$ 2.14

As at December 31, 2006, 3,663,938 options were exercisable (December 31, 2005 – 764,375).

The following table summarizes information about options outstanding as at December 31, 2006:

	Outstanding Options			Exercisable Options	
Range of exercise prices	Number of options	Weighted-average exercise price	Weighted-average life remaining (years)	Number of options	Weighted-average exercise price
$2.00 - $2.90	1,567,268	$ 2.41	4.36	963,941	$ 2.20
$3.00 - $3.30	928,632	3.30	3.38	699,997	3.30
$5.00 - $5.04	2,000,000	5.04	2.89	2,000,000	5.04
	4,495,900	$ 3.76	3.50	3,663,938	$ 3.94

i) In 2005, 487,494 Performance Vesting options were surrendered in exchange for 92,522 Time Vesting options with an exercise price of $2.00 per share and expiry of June 2008. The fair value of these options was estimated to be $37,640 using the Black-Scholes option pricing model, of which $2,017 was recorded as stock-based compensation expense in 2006 (2005 – $35,623).

ii) In October 2005, the Company granted 100,000 stock options with an exercise price of $2.00 to an officer of the Company. The options vest equally over a three-year period and expire in October 2010. The fair value of these options was estimated to be $33,130 using the Black-Scholes option pricing model, of which $11,040 was recorded as stock-based compensation expense in 2006 (2005 – $5,048).

iii) On February 2, 2006, the Company's Board of Directors approved a resolution to extend the expiry date of certain options granted in 2001, 2002, and 2003 by three years. The fair value of the effect of the modification of the option terms was estimated to be $238,782 using the Black-Scholes option pricing model. As all of the related options have vested, the entire fair value was recorded as stock-based compensation in 2006.

iv) On February 24, 2006, the Company amended its stock option plan to establish two tiers of Performance Warrant options and establish the number of shares reserved for issuance to directors, officers, employees and consultants pursuant to the Time Vesting and Performance Warrant options.

Under the amended plan, the number of shares available for issuance pursuant to the exercise of options are as follows:

a. Time Vesting options granted may not exceed 10 percent of the issued and outstanding common shares on a non-diluted basis;

b. Tier I Performance Warrant options granted may not exceed 5 percent of the issued and outstanding common shares on a non-diluted basis;

c. Tier II Performance Warrant options granted may not exceed 5 percent of the issued and outstanding common shares on a non-diluted basis.

All options granted on or after February 24, 2006 vest as determined by the Company's Board of Directors, unless the Company is sold or a change of control event (a "liquidity event") occurs prior to options fully vesting, at which time all options shall become fully vested.

The exercise price of Time Vesting options is established on the date such options are granted, equal to the price per share ("Performance Security Issue Price") at which common shares were sold, thereby increasing the number of options available for granting. Time Vesting options

expire at the earlier of five years from the date of grant or up to six months from the date on which the optionee ceases to be a director, officer, employee or consultant of the Company.

The exercise price of Performance Warrant options is not determinable until a liquidity event occurs. The exercise price of Tier 1 Performance Warrant options is equal to the Performance Security Issue Price x (1 + 15%)n and the exercise price of Tier II Performance Warrant options is equal to the Performance Security Issue Price x (1 + 40%)n, where n equals the number of years or partial years elapsed since such option became available for granting to the date of the liquidity event.

v) In February 2006, the Company granted 19,660 Time Vesting stock options with an exercise price of $2.90 to an officer of the Company. The options vest over a three-year period on a quarterly basis and expire in March 2011. The fair value of these options was estimated to be $15,044 using the Black-Scholes option pricing model, of which $3,133 was recorded as stock-based compensation expense in 2006.

vi) In May 2006, the Company granted the following options to employees and consultants of the Company, all of which vest over a four-year period on a quarterly basis and expire in May 2011:

a. 228,635 Time Vesting options, of which 227,325 options are exercisable at $3.30 and 1,310 options are exercisable at $3.00 per share. The fair value of these options was estimated to be $143,610 using the Black-Scholes option pricing model, of which $22,721 was recorded as stock-based compensation expense in 2006;

b. 226,931 Tier I Performance Warrant options and 226,931 Tier II Performance Warrant options. As the exercise price of the Performance Warrant options is not determinable until a liquidity event occurs, the fair value of Performance Warrant options cannot be determined.

vii) On July 20, 2006, the Company granted the following options, all of which vest as to one-third on each of the first three anniversaries of the grant date and expire July 20, 2011:

a. 699,997 Time Vesting options exercisable at $3.30 per share. The fair value of these options was estimated to be $1,273,245 using the Black-Scholes option pricing model, of which $191,858 has been recorded as stock-based compensation expense in 2006;

b. 837,037 Tier I Performance Warrant options and 837,037 Tier II Performance Warrant options. As the exercise price of the Performance Warrant options is not determinable until a liquidity event occurs, the fair value of Performance Warrant options cannot be determined.

viii) On July 20, 2006, the Company approved to cancel and replace all outstanding Tier I and Tier II Performance Warrant options with 2,000,000 Time Vesting options exercisable at $5.04 per share. The options vest immediately and expire on July 20, 2009. The fair value of these options was estimated to be $2,045,532 using the Black-Scholes option pricing model, all of which was recorded as stock-based compensation expense in 2006.

ix) On November 20, 2006, immediately following the business combination described in note 3, the Company's Board of Directors approved a resolution to modify and extend the expiry dates of all outstanding options by 0.1 to 3.4 years, for a weighted average extension of 0.4 years. The fair value of the effect of the modification of the option terms was estimated to be $304,262 using the Black-Scholes option pricing model, of which $284,191 of stock-based compensation expense related to the modification was recorded in 2006 based on the pro-rata vested portion of the options.

x) On November 28, 2006, the Company granted 390,000 options to employees of the Company. The options vest equally over a three-year period, have an exercise price of $2.75 per share and expire in November 2011. The fair value of these options was estimated to be $585,070 using the Black-Scholes option pricing model, of which $17,632 was recorded as stock-based compensation in 2006.

xi) On December 21, 2006, the Company granted 127,000 options to directors of the Company. The options vest equally over a three-year period, have an exercise price of $2.80 per share and expire in December 2011. The fair value of these options was estimated to be $194,160 using the Black-Scholes option pricing model, of which $1,773 was recorded as stock-based compensation in 2006.

d) Black-Scholes option pricing model

Under the Black-Scholes option pricing model the Company used the following assumptions to estimate the fair value of options granted and modified:

	2006	2005
Risk-free interest rate	**3.9% to 4.3%**	3.6%
Expected volatility	**1% to 60%**	1%
Forfeiture rate	**0%**	0%
Dividend yield	**nil**	nil
Expected life for options granted	**3 to 5 years**	5 years
Expected life for options modified	**0.5 to 5.4 years**	not applicable

e) Warrants

On November 20, 2006, in conjunction with the business combination described in note 3, all 3,710,800 outstanding warrants to acquire High Plains common shares at a price of $0.70 per share were consolidated on a 5-to-1 basis, for a total of 742,160 post-consolidated warrants exercisable at $3.50 per share. As the estimated fair value of the warrants on the business combination date was determined to be a nominal amount, no value has been ascribed to these warrants, all of which expired unexercised on April 14, 2007.

There were no Action warrants outstanding on the date of the business combination.

f) Escrowed shares

Pursuant to the terms of an escrow agreement dated November 24, 2006, 17,299,176 of the currently issued and outstanding common shares were escrowed and are scheduled for release in equal tranches of 25 percent over 18 months from November 20, 2006 (see note 3). As at December 31, 2006, 12,974,382 common shares remained in escrow.

g) Per share amounts

Basic per share amounts for the year ended December 31, 2006 are calculated using the weighted-average number of shares outstanding of 20,157,836 (2005 – 10,433,245). In computing diluted per share amounts, all of the Company's outstanding options and warrants have been excluded as they are anti-dilutive.

10. Contributed surplus

Balance, December 31, 2004	$	76,640
Stock-based compensation		82,162
Balance, December 31, 2005		158,802
Stock-based compensation		4,026,846
Settlement of convertible debt (note 6)		86,572
Balance, December 31, 2006	$	4,272,220

11. Change in non-cash working capital

		2006		2005
Accounts receivable	$	**(1,679,862)**	$	903,657
Prepaid expenses		**(171,227)**		(5,433)
Accounts payable and accrued liabilities		**6,038,913**		(2,686,531)
	$	**4,187,824**	$	(1,788,307)

The change in non-cash working capital has been allocated to the following activities:

		2006		2005
Operating	$	**(320,307)**	$	655,962
Financing		**(60,622)**		60,622
Investing		**4,568,753**		(2,504,891)
	$	**4,187,824**	$	(1,788,307)

12. Commitments

The Company has the following commitment pursuant to an office lease which expires March 2011:

2007	$	151,182
2008		155,892
2009		148,390
2010		148,360
2011	$	37,090

13. Segmented information

	December 31, 2006					
		Canada		United States		Total
Revenues, net of royalties	$	3,672,950	$	108,718	$	3,781,668
Net (loss) income		(6,932,084)		30,887		(6,901,197)
Net (loss) income per share						
– basic and diluted		(0.34)		0.00		(0.34)
Total assets		86,147,334		4,136,672		90,284,006
Property and equipment		71,798,073		3,742,829		75,540,902
Expenditures on property and equipment	$	19,099,702	$	31,001	$	19,130,703

The Company's United States operations were acquired through the business combination described in note 3. As a result, segmented information was not required prior to November 20, 2006.

14. Financial instruments

a) Fair values of financial assets and liabilities

Financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and bank debt. At December 31, 2006 and 2005, there were no significant differences between the carrying amounts reported on the balance sheet and estimated fair values.

b) Credit risk

The majority of the Company's accounts receivable are in respect of oil and natural gas operations. Management believes the risk is mitigated by the size and reputation of the companies to which the Company extends credit.

c) Commodity price risk

The Company's operations are exposed to commodity price fluctuations. The Company has not entered into any hedging arrangements.

d) Interest rate risk

Interest rate risk is the risk that the value of a financial instrument might be adversely affected by a change in the interest rates. The Company is exposed to interest rate risk primarily through its variable interest rate bank debt as disclosed in note 6.

e) Foreign currency risk

The Company is exposed to foreign exchange rate fluctuations as certain revenues and expenditures are denominated in U.S. dollars.

15. Contingencies

As at December 31, 2006, there were several outstanding legal proceedings that had been previously filed against High Plains. The claims total approximately $950,000, the majority of which is anticipated to be settled through the swap of various joint properties. In addition, a claim in the amount of $3.4 million has been recently filed against the Company in regards to costs associated with a farm-out arrangement. The Company has filed a counterclaim for unpaid amounts and funds from revenue are currently being held in trust.

The ultimate settlement of the disputes and amounts is dependent upon the outcome of future contingent events, the nature and likelihood of which cannot be determined at this time. The adjustment, if any, on resolution of this matter will be accounted for in the period of determination.

16. Related-party transaction

Included in expenses and share issue costs are amounts totalling $521,043 (2005 – $48,889) which were charged to the Company by a legal firm in which a Director and the Corporate Secretary of the Company are partners. Included in accounts payable and accrued liabilities as at December 31, 2006 is $88,069 (2005 – $48,189) in respect of these amounts.

17. Subsequent events

a) On February 5, 2007, the Company granted 204,081 options to purchase common shares. The options are exercisable at a price of $2.75 per option and vest over three years (1/3 on each of the first, second and third anniversary of the grant date). The options expire in five years, February 5, 2012.

b) On April 11, 2007, the Company announced that it has entered into an agreement with a syndicate of investment bankers to raise $12 million through the issuance of 3,160,000 common shares on a flow-through basis with an underwriters' option for an additional $3.0 million or 790,000 common shares on a flow-through basis. The related tax benefits of the flow-through proceeds will be renounced to investors in February 2008 with an effective date of December 31, 2007 and the Company will have until December 31, 2008 to incur the $15 million of qualifying flow-through expenditures. The Company anticipates closing this financing during the second quarter of 2007.

Corporate Information

Board of Directors

Roger C.W. Tang, M.Sc.
Chairman and Chief Executive Officer

R.D. (Bob) Bowman, B.Sc.
Director, President, Chief Operating Officer and Chief Financial Officer

Andrew J. Byrne, CFA(1) (3)
Director

John H. Campbell, Jr.(3)
Director

Walter Dawson(2) (4)
Director

William J. Quinn(2)
Director

Scott Soler, C.P.A.(1) (4)
Director

Lamont Tolley(1) (3)
Director

Gregory Turnbull (2) (4)
Director

(1) Member of Audit Committee
(2) Member of Compensation Committee
(3) Member of Reserves Committee
(4) Member of Corporate Governance Committee

Management Team

Roger C.W. Tang, M.Sc.
Chairman and Chief Executive Officer

R.D. (Bob) Bowman, B.Sc.
Director, President, Chief Operating Officer and Chief Financial Officer

Adeline L. Roth, CA
Vice President, Finance and Controller

Douglas H. Cole, B.Sc, MBA, P.Eng.
Vice President, Corporate Development

Warren J. Doenz, P. Geol.
Vice President, Exploitation

Ron Honch
Geological Manager

Jim Corner
Chief Geologist

Jeff Rideout, P. Land, MBA
Manager, Land

James Schneider
Manager, Operations

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